

# The Greening of Risk

*Even companies that saw changes coming years ago will have to raise their game in environmental risk and compliance.*

BY KATHERINE HEIRES

**C**orporations today are either up to speed when it comes to managing their environmental risks, or they are jeopardizing their viability. The warning comes not from an outspoken environmental activist, but rather from investment analyst Cary Krosinsky, co-editor of the book “Sustainable Investing: The Art of Long Term Performance” and vice president of Trucost, an environmental research firm based in London.

The sentiment may seem as fresh and pointed as the latest scientific pronouncement on global warming, but not for Trucost, which began advising private- and public-sector clients on environmental performance and business impacts in 2000. That same year, Santa Clara, California-based Applied Materials hired Bruce Klafter as a then-new kind of risk manager. A lawyer previously serving as a consultant to the semiconductor equipment company, Klafter became its full-time director of environmental, health and safety (EHS) legal affairs. In 2004 he was promoted to head of EHS, and he currently manages a team of more than 50, including one full-time lawyer, involved in the company’s compliance and environmental activities.

Klafter defines his role as “that of a risk management professional charged with assessing and anticipating environmental risks.” He considers ongoing analysis of the impact of climate change on business operations and periodic reviews and updates of business processes to be critical aspects of his job. He oversees energy usage, coping with resource scarcity and the control of toxic waste, the official release of carbon footprint numbers and establishment of emission-reduction goals, and outside environmental advisers who assist Applied Materials in its sustainability strategies. Klafter also represents the company in organizations such as the Association of Climate Change Officers (ACCO) and Sustainable Silicon Valley, and is active on the environmental and energy committees of the

Silicon Valley Leadership Group.

“The challenge for anyone overseeing a company’s environmental risk management is finding the right balance among multiple factors – the reputational impact, one’s relationship to the community and other stakeholders such as one’s employees, investors and company management – and then identifying and taking actions that are cost effective, reasonable, and give you and your stakeholders the assurance that you have the risks well controlled,” Klafter says.

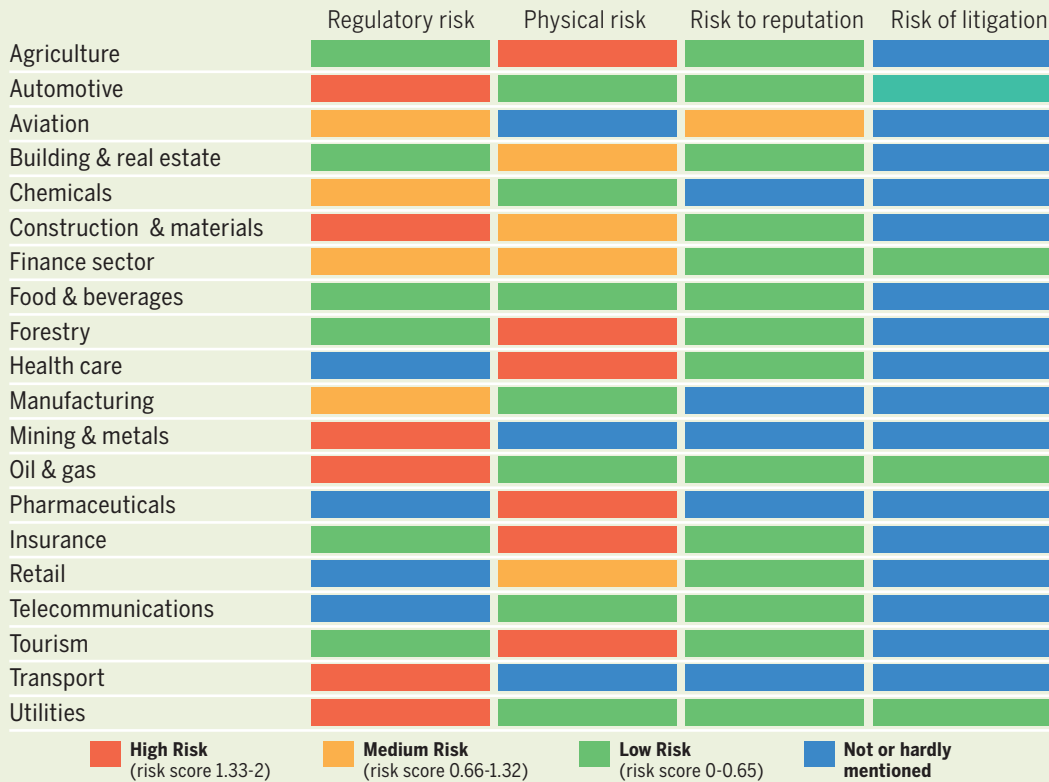
That’s a mouthful, but it accurately reflects a complex reality, experts say. “Companies are either evolving and recognizing the multitude of risks and opportunities associated with climate change for their sector, or they are not,” says Trucost’s Krosinsky, who is based in New York. “While environmental challenges are often very sector-specific, the benefit of recognizing the impact of environmental change and acting upon that knowledge determines whether or not you will be a healthy, surviving company.”

The classic object lesson comes from the auto industry. Toyota Motor Corp. “made the right gamble” on fuel-efficient cars, Krosinsky says, while General Motors Corp. “was late to the sustainability game.” GM ultimately paid the price of bankruptcy.

Notes Peter Gray, co-founder of ACCO and a partner of McKenna Long & Aldridge in Washington, D.C., “Climate change from a corporate perspective is not simply about compliance. Increasingly it’s about a much broader set of issues related to energy usage and planning for new, alternative sources of energy.”

But despite the risk awareness and management responses at companies like Applied Materials and Toyota, corporations across the board will need to step up their environmental risk efforts even further in the face of anticipated climate change, regulations and investor interest in companies’ environmental and sustainability performance.

## Perceived Risk Levels, By Sector Based on average risk assessment scores from KPMG's *Climate Changes Your Business* report



### Regulatory Urgency

“Dealing with climate change is now driven by regulation and other market forces that are already in motion,” asserts Gray. He adds that debate has subsided over whether climate change is a reality or not, but whichever side of the issue one takes, “companies now have to factor climate-change regulations and their impacts into their business decisions – and rather swiftly.”

Regardless of the pace of federal climate regulation, 10 northeastern states, for example, have joined the Regional Greenhouse Gas Initiative, effective last January. Greenhouse gas (GHG) emissions will be capped at 2009 levels until 2015.

In March, the U.S. Environmental Protection Agency (EPA) proposed that companies start to report emissions of carbon dioxide and five other GHGs starting in fiscal year 2010, with

the first reports due in March 2011. The American Clean Energy and Security Act that the House passed in June calls for establishment of a national cap-and-trade program that would set corporate limits on GHG emissions and result in declines of 14% from 2005 levels by 2020, and 83% by 2050.

The resulting trading market could raise an estimated \$79 billion from auctioning of allowances in its first year, rising to \$646 billion by 2019, according to U.S. government estimates. Companies that are well prepared for cap-and-trade and its associated risks are more likely to benefit. “There will be winners and losers,” Gray said.

“You don’t want to . . . have new rules come into effect and not know what your emission levels were in 2005,” says Eric Israel,

managing director of consulting firm KPMG’s sustainability advisory practice. “The sooner companies start to fully understand all the risks involved in addressing environmental issues, the better they will position themselves for the future.”

With pressure to address environmental risk management mounting, what should savvy companies be doing?

According to a 2008 KPMG report (see chart), they should focus in three key areas: Invest in understanding the risks associated with climate change and bring risk management expertise to bear on these developments; assess and act upon investment in opportunities that come with these risks, including development of alternative energy sources; and disclose carbon costs, the carbon footprint and other environmental matters of interest to stakeholders.

Among the many challenges along these paths, “there is far

too much variation in the reporting standards,” says KPMG’s Israel. He points out that many company reports to date are not third-party-verified. “How do we know if the emissions information is really accurate? From a risk management perspective, this is my biggest concern,” Israel says.

ACCO executive director Dan Kreeger is concerned about talent. The profession is “in its infancy,” he says, adding, “Many of the people who have been focused on climate change issues have only been around for half an hour.” On the other hand, organizations such as ACCO, established last year, are helping to identify best practices, provide training and facilitate networking among risk managers and other executives.

David Metcalfe, CEO of Verdantix, a business research firm in London focused on climate, energy and sustainability, recommends that companies recruit for and establish cross-functional risk committees. The necessary expertise is “rare,” he contends, “and most organizations are just at the point of getting started with these issues.”

**M**etcalfe also recommends that companies consider bringing in outside help. According to a Verdantix report this year, the landscape includes consulting firms including the Big Four and specialists such as Acclimatise, AIR Worldwide, Climate Change Risk Management, DNV, Maplecroft, Marsh Risk Consulting and Risk Management Solutions. What’s more, there are a growing number of systems from the likes of Enablon, Hara Software, SAP and SAS Institute to streamline the data collection and monitoring, recordkeeping and strategic planning requirements of environmental risk management.

## Data Management Challenge

“Many companies are having a hard time gathering data to identify their carbon footprint,” says Marty Etzel, vice president of sustainability solutions at enterprise resource planning giant SAP, which in May acquired Clear Standards, a company that offers Web-based, hosted software to help enterprises measure, optimize and report GHG emissions and calculate corporate-wide costs. SAP is even offering a new application to track carbon emissions via iPhones. Etzel says the company is working on an update to address the impact of cap and trade legislation.

“Three years ago, it was only chemical, oil and gas, cement and utility companies that were interested in this,” Etzel observes. Now any industry involved in monitoring their carbon footprint and energy usage is interested in these offerings. Inter-

est has grown beyond the traditional smokestack industries.”

Banks including JPMorgan Chase & Co., Citigroup and Morgan Stanley have adopted the Carbon Principles, committing to factor in the cost of emissions or mitigation in their investment decisions and advice. More than 315 institutional investors with over \$41 trillion in combined assets under management have joined the Carbon Disclosure Project that encourages private- and public-sector organizations to measure, manage and reduce emissions and climate-change impacts.

In line with this development, firms such as Trucost are working with fund managers at Deutsche Bank, UBS and Vanguard Group on analyzing environmental risks and costs. RiskMetrics Group in March acquired Innovest, one of the first firms to apply sustainability metrics to investment valuations, and recently appointed Heather Langsner as director of sustainability research. Discount retailer Wal-Mart announced this summer that it expects all suppliers to evaluate and provide information on the environmental costs of their products in terms of water use, GHG emissions and solid waste production, with the information to be shared with Wal-Mart customers.

For the data gathering effort, France-based Enablon, meanwhile, emphasizes its ability to integrate both risk and sustainability management into an all-in-one, Web-based program. Philippe Tesler, North American CEO, says that integration allows information gathered by the EHS application to feed the risk application, automatically creating a holistic risk profile that otherwise would require considerable extra effort.

Another distinction of Enablon, Tesler says, is its real-time display, as opposed to before- or after-the-fact systems. “The benefit is a real-time view of risk, allowing exposure and control levels to be automatically updated using the latest EHS performance and compliance information,” Tesler explains, adding that the platform is designed to help companies measure and track carbon emissions, set reduction objectives, implement and follow up on those programs and do scenario analysis.

Tesler expects to see corporations take the data that has been processed by the Enablon system and directly publish it online for shareholders and other stakeholders to review. “The integration of risk management and sustainability management will become the new norm,” he predicts, “allowing companies to manage and mitigate risks with a multidimensional view that links operations, finance and image.”

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