4.1 CLIMATE-RELATED TRANSITION RISKS

Types of climate-related transition risks

Important notice
This unit is part of a package of learning materials designed to support understanding of foundational concepts relating to climate-related financial disclosures. These learning materials do not constitute application or regulatory guidance for the preparation of climate-related financial disclosures and are not intended to represent legal or professional advice. We encourage you to seek your own professional advice to find out how the *Corporations Act 2001* (Corporations Act) and other relevant laws may apply to you and your circumstances, as it is your responsibility to determine your obligations and comply with them.

Key topics

- Climate-related transition risks
- Financial implications that may arise from transition risks

Relevance for climate-related disclosures

Understanding climate-related risks, including climate-related transition risks, will help entities with their climate-related disclosures.

In this unit, you will learn about different types of climate-related transition risks.

Overview

Climate-related risks are the potential negative effects of climate change on an entity and are characterised as climate-related physical risks and climate-related transition risks.

Climate-related transition risks arise from the efforts to transition to a lower-carbon economy and can stem from changes in policy and legislation, legal developments, new technologies, evolving markets and shifting stakeholder expectations. These risks may have financial implications for entities.

Climate-related physical risks are covered in Module 3 Units 1-8.

Understanding climate-related transition risks

Climate-related risks are the potential negative effects of climate change on an entity and include both physical risks (see Module 3) and transition risks. Unlike physical risks, which arise directly from the physical impacts of climate change (such as extreme weather events or sea level rise), climate-related transition risks stem from societal responses to climate change – specifically, the shift towards a lower-carbon economy. While indirect, these risks are still fundamentally driven by the underlying challenge of climate change. These risks can carry financial implications, such as increased operating costs or shifting consumer demands. Figure 1 shows the difference between physical and transition risks, highlighting how each type might impact an entity in different ways.

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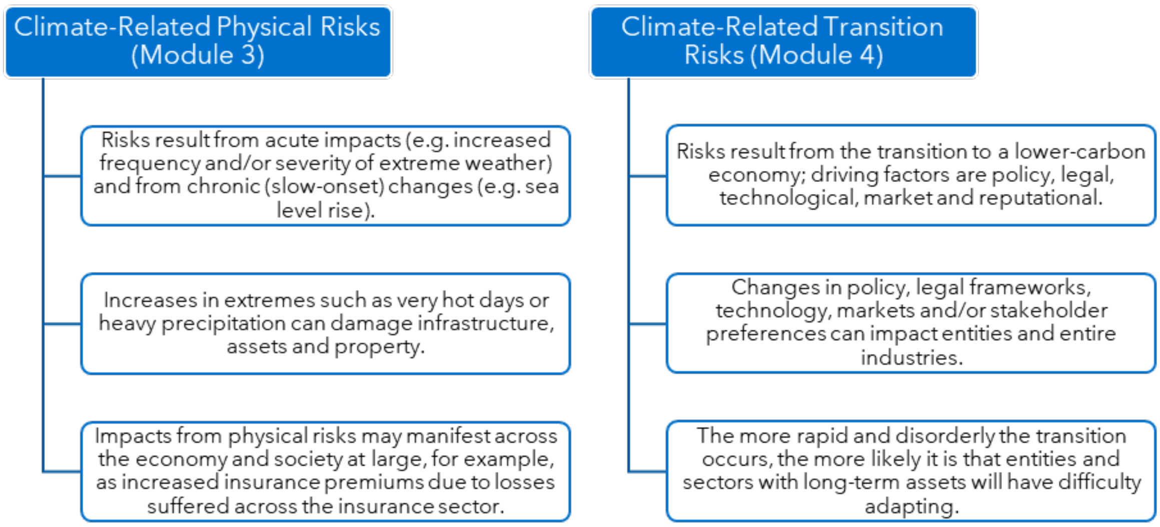

Figure 1: How climate risks can affect your entity: physical versus transition risks

Climate-related transition risks are risks that arise from efforts to transition to a lower-carbon economy.

Transition risks include policy, legal, technological, market and reputational risks. These risks could carry financial implications for your entity, such as increased operating costs or asset impairment due to new or amended climate-related regulations.

Your entity's financial performance could also be affected by shifting consumer demands and the development and deployment of new technology.

In other words, your entity might face risks due to the introduction of new laws, changes in technology, or shifts in consumer preferences. Below are some examples of each type of risk:

- **Policy or legal risks** may arise from stricter climate regulations, carbon pricing, false claims about your entity's climate credentials or greenwashing, or new government policies such as the Safeguard Mechanism which requires reductions in greenhouse gas emissions, or greater physical impacts of climate change leading to more government policy intervention in future.
- **Technology risks** may arise if your entity needs to replace outdated equipment with more climate-friendly alternatives or if your entity needs to undertake write-downs (e.g. if an asset such as machinery or an industrial plant can only operate in a carbon-intensive way and becomes less profitable over time due to a shift to low-carbon technology, it will have a diminished ability to generate returns).
- **Market risks** may arise as consumer demand or investor expectations shift away from high-emission products, thus leading to revenue losses or supply chain pressures.
- **Reputation risks** may arise if your entity is perceived as making slower-than-expected progress on climate action, potentially leading to a loss of investor confidence, exclusion from ESG investment portfolios, or increased stakeholder scrutiny (e.g. negative media coverage, public concerns, or consumer boycotts).

How climate-related transition risks can impact your entity

Table 1 provides practical examples of climate-related transition risks and potential financial implications.

Table 1: Transition risks, hypothetical examples and potential financial implications

Transition risk	Hypothetical example	Potential financial implications
Policy	A regional food manufacturer faces higher logistics costs due to stricter emission standards under jurisdictional net-zero policies.	↑ Operating costs
Legal	A private company receives a civil penalty for making unsupported carbon-neutral claims in product marketing.	↑ Legal costs ↓ Reputation
Technology	A logistics firm delays upgrading its vehicle fleet as lower-emission vehicles become common across the industry, resulting in reduced access to contracts.	↓ Market access ↑ Capital expenditure
Market	A medium-sized company loses a retail contract because a buyer moves toward suppliers with lower-emission supply chains.	↓ Revenue ↑ Compliance costs
Reputation	A construction firm is excluded from a government supplier panel for lacking a credible emissions reduction plan.	↓ Market access ↓ Reputation

The examples in the table highlight how climate-related transition risks may affect your entity and potentially lead to financial implications, such as:

- higher costs (e.g. due to compliance with new emissions standards or legal penalties)
- decreased revenue or market access (e.g. from lost contracts or failure to meet buyer criteria), and
- decreased reputation (e.g. from a perceived slow response or misleading claims).

Climate-related transition risks often interact and reinforce each other. For example:

- new policy may accelerate technology change
- legal risks may rise if reputational harm leads to stakeholder action, and
- market risk may materialise faster in response to regulatory or technological disruption.

Key takeaways

- Climate-related transition risks arise from efforts to transition to a lower-carbon economy.
- They include policy and legal risks, technology risks, market risks, and reputational risks.
- These risks could have financial implications for your entity, such as higher costs, or decreased revenue or market access.