4.4 CLIMATE-RELATED TRANSITION RISKS

Case study 1: Policy-related 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.

The company featured in this case study is entirely fictional and presented for illustrative purposes only. It is not intended to represent any real business, past or present. Any resemblance to actual entities is purely coincidental. Different entities have different climate-related risks and opportunities, and so this scenario may not be relevant for your entity.

Key topics

- Climate-related transition risks for entities – policy-related
- Impacts on entities' strategy and operations

Relevance for climate-related disclosures

This unit's case study will help you to understand how climate-related transition risks, in this case a policy-related risk, can impact entities, including through their value chain.

Overview

This unit explores a case study designed to illustrate key concepts related to climate-related transition risks, specifically policy-related risks. It is a hypothetical example involving a fictional small manufacturing company in Western Australia, grounded in real-world policy measures. It may give you practical insights into:

- identifying climate-related transition risks across the value chain
- assessing financial, operational, strategic and governance impacts
- considering recovery and response strategies.

Introduction

This case study may help you reflect on how similar climate-related policy risks could affect the operations and financial performance of your entity. The scenario is intended to prompt consideration of potential vulnerabilities and resilience strategies. This scenario does not describe real events or a real entity but is grounded in realistic conditions experienced by manufacturers.

Sector: Manufacturing - industrial coatings
Entity: Coatings manufacturing
Location: Western Australia
Transition risk type: Policy-related

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What is the scenario?

CoatingTech Industrial Coatings is a manufacturer based in Perth that produces specialty coatings for use in infrastructure and mining. While its operations are relatively modest, one of its key clients is a cement manufacturer covered under the Australian Government's Safeguard Mechanism, which requires certain large industrial facilities to reduce emissions over time.

In July 2023, the *Safeguard Mechanism (Crediting) Amendment Act 2023* came into effect, requiring covered facilities (those emitting more than 100,000 tonnes of carbon dioxide equivalent (tCO_2-e) per year) to progressively reduce emissions in line with national targets. The policy places indirect pressure on smaller businesses within value chains to support decarbonisation and energy saving targets.

To meet its own decarbonisation targets, the cement customer requests that CoatingTech develops coating alternatives that contribute to energy savings. The development of new product lines requires investment in research and development and quality testing, which strain CoatingTech's limited technical and financial capacity. But if CoatingTech cannot meet the client's new procurement criteria, the cement company may switch to an alternative supplier. There is little ability to pass on higher input costs associated with reformulated products.

What are some potential business impacts?

Financial

- Higher production costs
- Loss of revenue if new criteria cannot be met
- Increased research and development investment needs
- Long-term cost savings despite initial investment

Operational

- New production process and training requirements to match production changes
- Quality testing needs
- Initial risk of delayed product supplies
- Energy-efficient production methods and a more skilled workforce

Strategic

- Need to innovate and develop coating alternatives that contribute to energy savings
- Need to reposition product portfolio
- Low-emission or energy-saving coatings could position CoatingTech as a preferred supplier to multiple clients
- Possibility of opening new market segments or export opportunities

Governance

- Risk oversight role to include monitoring climate-related policy changes
- The process of applying for grants and forming partnerships can help build institutional networks and strengthens relationships with government agencies and research partners

What is the response strategy?

The entity applies for a government grant and explores a new research and development partnership.

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