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*(**Editor's Note:** This article, by Standard & Poor's Ratings Services' President Neeraj Sahai, first appeared in Fortune magazine on July 9, 2014.)*

It's a question many companies haven't answered fully, even though carbon emissions pose a real threat to their bottom lines.

The Environmental Protection Agency's proposed regulations to reduce carbon emissions are generating heated debate about climate change. But one thing is clear: Companies need to do much more to explain to investors the climate-related risks the companies face and how they are managing them.

Extreme weather events appear to be getting more severe and more frequent, as the recent drought in California and floods in Europe reminded us. Weather events accounted for 90% of natural catastrophe losses in 2013, causing over $120 billion of losses, according to reinsurance company Munich Re. In 2012, the overall effect of climate events on the U.S. and European economies is estimated at more than $5 trillion for each region, or over 30% of their GDP.

The investment community--along with regulators--has woken up to this threat. It is demanding more information from companies about their exposures to climate events, as well as the prospective costs of their carbon emissions.

A wide array of businesses--not just insurers and carbon-intensive corporations--are being pressed to demonstrate how they are managing these long-term issues. Their future cost of capital will in part hinge on the answers they give.

Unfortunately, too many businesses still provide investors and other stakeholders only a partial picture of the risks they face. And they offer an incomplete explanation of how they are mitigating these exposures.

The corporate sector is nimble at meeting growing investor demand for environmentally friendly assets. Private-sector companies' issuance of green bonds, which fund environmentally beneficial capital investment, is growing rapidly. According to Standard & Poor's Ratings Services, it is likely to double this year to around $20 billion.

However, businesses are proving much slower in providing investors with robust information about their wider climate- and carbon-related risks.

Climate risk, along with the impact of carbon pricing, carries direct and indirect exposure for a company. It potentially affects its entire value chain, from production through to distribution and sales. Floods and blizzards disrupt suppliers and dislocate manufacturing, but they also can curb consumption.

Over the long term, extreme weather can damage both profitability and asset valuations in unexpected ways. Companies that fail to take account of these risks may suffer significant stress and have little flexibility to manage their exposure.

Companies frequently focus on communicating their direct liability to carbon emissions regulation, notably the net

cost of carbon permits they are required to hold under emissions trading schemes. These costs are important and, notwithstanding the recent decline in carbon credit prices, are likely to grow over time. But many companies ignore the--potentially much larger--costs of a carbon liability being passed down the supply chain or changing end demand for products and services.

Energy, materials, industrial, and utility companies have the highest direct carbon intensity and therefore the largest regulatory exposure to emissions compliance schemes.

But the property and financial services sectors are also exposed to climate risk due to the life cycle of buildings and the nature of their long-term investments. All sectors, in fact, are affected to varying degrees by climate and carbon risks.

Conventional financial analysis of carbon risk overlooks the "shadow liability" caused by potential carbon price liabilities from indirect exposures across the value chain.

This shadow liability is hard to analyze, as data are patchy and valuation methods vary. Inconsistent disclosure requirements around the world do not help either.

In the U.S., the Securities and Exchange Commission requires firms that file annual reports to communicate material climate change risks. In April, the European Parliament approved new rules that will require large listed firms to publish environmental and social data in their reporting to investors. But this falls far short of a comprehensive and coordinated disclosure regime for companies' overall exposure to carbon and climate risk.

Investors, meanwhile, are not standing still. They are starting to conduct their own analysis of indirect carbon price risk and its impact on corporate investment returns and credit quality.

Independent analysts who serve them are doing the same. Standard & Poor's, for instance, is seeking to assess the effects of carbon price risk on a company's creditworthiness by considering the direct and indirect impact on profitability, asset and liability valuation, and cash flow. Organizations like the international Carbon Disclosure Project are surveying companies about their environmental exposures and scoring them accordingly.

Some large companies are responding. ExxonMobil recently became the first oil and gas producer to publish details of its climate risk exposure from stranded assets (reserves that it could not exploit if regulation is tightened). But most businesses have yet to accept that climate and carbon risks are ever more material to corporate performance and value.

Business leaders should acknowledge that climate risk and carbon liabilities are here to stay and, in all probability, set to grow. If they cannot demonstrate effective assessment and management of these short-term and long-term liabilities, their creditworthiness may suffer and their financing costs will rise.

Capital markets participants traditionally have short-term horizons. But environmental change is a long-term issue that they cannot ignore. Over time, it will play an increasing role in determining both financial risk and return.

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