Task Force on Climate-related Financial Disclosures Working Group

2020 Annual Summary Report

In 2020, the UN Global Compact Network UK launched a Working Group to foster dialogue regarding the Task Force on Climate-related Financial Disclosures (TCFD). The Working Group explored opportunities and issues arising from the TCFD, and supported companies' adoption of the recommendations.

The TCFD Working Group held four virtual meetings between June 2020-February 2021, during which experts and members shared their insights, experience, and learnings of TCFD reporting. The meetings covered the following aspects:

- *Implementing the TCFD recommendations.*
- *Current status of TCFD aligned disclosures.*
- *External influences and drivers of TCFD reporting.*
- *Methods for conducting scenario analysis.*

This report aims to summarise the key learnings from these meetings.

1. Implementing the TCFD recommendations

TCFD overview

The Financial Stability Board (FSB) set up the TCFD in 2015 to develop comparable and consistent climate-related financial risk disclosures that companies can use to demonstrate climate change resilience to investors, lenders, insurers, and other stakeholders.

There are a total of eleven recommendations to aid companies in their disclosures. These are structured around four core elements: Governance; Strategy; Risk Management; and, Metrics and Targets. The elements and recommendations should be thought of holistically.

Getting started and the TCFD journey

Companies could consider the following points to aid them in implementing the TCFD recommendations:

- Secure the support of your board of directors and executive leadership team. It is helpful to have a champion from senior management who can support you in driving this process through the company and gaining internal buy-in.
- Integrate climate change into key governance processes, enhancing board-level oversight through audit and risk committees.
- Convene individuals from sustainability, governance, finance, strategy, and compliance departments to support ongoing implementation.
- Look at existing tools you may already use to help you collect and report climate-related information (e.g., CDP, CDSB, SASB, WWF Water Risk Filter Tool).
- Solicit feedback from engaged investors to understand the information they need.

- Disclose information on the Risk Management and Governance elements of the framework even if climate change does not present material risks to your company.
- Explore the structure of your annual report and consider how you can incorporate the recommendations. Companies may find it useful to provide a mapping of sections in their report where the reader can find information that addresses the recommendations.

Creating a roadmap at the start of the TCFD journey can also provide companies with guidance on how to proceed:

1) Create an internal working group.
2) Conduct a gap analysis of existing processes and disclosures.
3) Develop scenario analysis.
4) Integrate climate-related information into decision-making.
5) Embed climate-related risks and opportunities into risk management and decision-making processes, and appropriately disclose this to the market.

Resources

CDSB Presentation Slides – Overview of the TCFD presented by the Climate Disclosure Standards Board (CDSB).

TCFD Final Recommendations – This report sets out the TCFD's recommendations for helping businesses disclose climate-related financial information.

TCFD Good Practice Handbook – This handbook offers some specific examples of different aspects of effective TCFD reporting across the four core TCFD elements of Governance; Strategy; Risk Management; and Metrics and Targets. Good practice examples are drawn out from across sectors and geographies.

TCFD Knowledge Hub – The TCFD Knowledge Hub is home to a range of resources such as guidance documents, research insights, best-practice case studies, and online courses to support companies in implementing the recommendations.

Guidance on Risk Management Integration and Disclosure – This document was developed to help address some of the issues companies may face in implementing the Risk Management recommendations.

Accounting for Sustainability (A4S) TCFD Insight Series – A4S is producing several TCFD reporting examples with the intention of highlighting good practices for finance and accounting professionals who are supporting implementation of the TCFD recommendations.

2. Current status of TCFD-aligned disclosures

The TCFD and other actors continue to assess the uptake of TCFD-aligned disclosures by firms. Essentially, disclosure has steadily increased since the recommendations were published in 2017.

- Key findings from the TCFD 2020 Status Report (which examines progress of TCFD-aligned disclosures by firms), show:
    - Approximately 60% of the world's 100 largest public companies support the TCFD, report in line with the TCFD, or both.

    - 700 organisations have become TCFD supporters since the 2019 status report, an increase of 85%.
    - Disclosures are primarily found in companies' sustainability reports but may also be found in Annual Reports and Single-Issue Reports (e.g., scenario analysis).
    - Only 1 in 5 companies disclosed information on the resilience of their strategy, significantly lower than any other recommended disclosure.
    - While the impact of climate change on a company's business and strategy was found to be the most useful for investors' decision making, disclosures on this remain low.
    - Information about a company's material climate-related issues for each sector and geography, and its key metrics, were also found to be extremely useful.
- Many companies have deprioritised medium-term climate-related investment to focus on near-term survival (organisational capacity, lack of government climate policy, and regulatory barriers are the biggest obstacles for the long-term transition towards net-zero emissions).

In November 2020, the UK Government released a roadmap that set out an indicative path towards mandatory climate-related disclosures across the UK economy aligned with the TCFD recommendations. Mandatory disclosures are expected across the economy by 2025, with a significant portion of mandatory requirements in place by 2023.

Resources

TCFD 2020 Status Report – The third status report of the TCFD, published in October 2020, outlines the findings of their annual review of company reports in order to better understand current climate-related financial disclosure practices and how they have evolved.

UK Government's Roadmap towards mandatory climate-related disclosures – This document sets out a path towards mandatory climate-related disclosures across the UK economy aligned with TCFD recommendations.

3. External influences and drivers of TCFD reporting

Climate change presents a systemic risk to the UK economy and financial system. As investors and banks work to manage their own risks, companies can expect increasing engagement from these actors to improve disclosures and demonstrate how they are also managing climate-related risks.

The Inevitable Policy Response

In anticipation of policy changes by the government, the UN Principles for Responsible Investment (UNPRI) developed a programme of research called the Inevitable Policy Response (IPR). The IPR presents the policies that are likely to be implemented in the next decade and quantifies the impact of this response on the real economy and financial markets.

What do investors want from companies?

As investors become increasingly regulated, and the impacts of climate change become ever more present, they will be looking to increase engagement with companies. Investors want to use information provided by companies to:

- Inform their own disclosures and decision making, particularly with regards to risk management and asset allocation.

- Assess the exposure of companies and the likelihood and impact of certain risks to understand the potential impact on valuation and cash-flow.
- Understand whether a company, its business model, and its revenues will remain robust regardless of different transition pathways and varying physical risks.
- Understand the role companies are playing to help or hinder the climate transition.

From a qualitative perspective, there are a range of questions that investors will be asking companies:

- Does the company have a clear climate strategy?
- Over what time scale does that strategy come into play?
- Who is responsible for that strategy?
- Where does the strategy fall within the business?

From a quantitative perspective, investors are interested in the metrics that companies use to assess climate-related risks. Investors want the ability to translate metrics around emissions and production into financial metrics to assess impacts on revenues, assets, and liabilities under different scenarios:

- Emissions intensity – production.
- Internal carbon price.
- Taxonomy thresholds – establishes whether a company is on a net zero emissions by 2050 trajectory and provides a benchmark to assess how far-off companies are in relation to that pathway.

There are various desired improvements cited by investors to improve usefulness of disclosures:

- More widespread adoption of disclosures by companies.
- Greater clarity on the financial impact of climate-related disclosures.
- Increased availability of disclosures – more identifiable within their annual reports.
- Disclosure of standard industry-specific climate-related metrics.
- Use of standard scenarios for assessing strategic resilience to climate change.
- Accelerated growth in science-based targets.
- More engagement between companies and investors.
- Consistent and reliable climate-related financial disclosures.
- Alignment on accounting standards relevant to climate-related financial disclosures.

<u>The role of the Bank of England in tackling climate change</u>

Climate change does not only raise environmental questions. The Bank of England is concerned about the impact of climate change on the UK economy and financial system and considers climate change to be firmly within its mandate.

- The Bank's climate objective is to "build a UK financial system resilient to the risks from climate change and supportive of the transition to a net-zero economy."
- As part of this, the Bank has set supervisory expectations for how banks and insurers should enhance their approaches to managing the financial risks from climate change. These expectations cover:
    - Governance;
    - Risk management;
    - Scenario analysis; and
    - Disclosure.

- The deadline for fully embedding these expectations is the end of 2021. Banks and insurers will also need to collect information from their clients about their exposure to, and their management of climate-related risks and opportunities.

Resources

Testing the TCFD Framework – An Equinor and Storebrand Case Study – This report was published to demonstrate how investees were aligning with TCFD recommendations and how investors use such disclosures.

Discussion Paper: Bank of England's 2021 biennial exploratory scenario on the financial risks from climate change – This discussion paper sets out the Bank of England's proposed framework for conducting the 2021 biennial exploratory scenario (BES). The objective of the BES is to test the resilience of the current business models of the largest banks, insurers, and the financial system to the physical and transitional risks from climate change.

Climate Action 100+ Progress Report (2020) – A summary report on the overall progress of the Climate Action 100+ initiative, including an update on measurement and benchmarking, key focus company commitments against the initiatives goals, and a sector level update on company performance against a set of indicators aligned to the aims of the initiative.

Climate Financial Risk Forum (CFRF) Guide – The CFRF, co-chaired by the FCA and the Prudential Regulation Authority, published this guide to help financial firms understand the risks and opportunities that arise from climate change, and provides support for how to integrate them into their risk, strategy, and decision-making processes.

The Inevitable Policy Response (IPR) – A forceful policy response to climate change within the near term is not priced into today's markets. However, it is inevitable that governments will be forced to act more decisively than they have so far, leaving investor portfolios exposed to significant risk. The IPR is a forecast of the potential financial impact of this inevitable response.

Enhancing banks' and insurers' approaches to managing the financial risks from climate change – This report provides details of the Bank of England's expectations for financial firms, concerning their strategic approaches for managing climate-related risks.

4. Methods for conducting scenario analysis

What is scenario analysis and why is it important?

Scenario analysis is a tool which can be used by companies and financial institutions to help them better understand the implications of climate change, and prompt strategic thinking about risks and opportunities under a range of conditions. Scenario analysis is included in the 'Strategy' pillar of the TCFD's recommendations. A scenario describes a path of development leading to a particular outcome (e.g., 1.5°C or 4°C increase in average global warming).

Scenario analysis can be used to:

- Understand the potential scale of risks and opportunities.
- Gain insight into risk hotspots throughout an organisation's value chain.
- Understand what changes will need to be made to adapt to the impacts of climate change and manage risks.
- Support companies to improve disclosure around climate risks, and their ability to respond to questions from investors, NGOs, customers, and employees.

- Help investors and other financial institutions make judgments about the resilience of companies to the risks of climate change.

TCFD recommendations for using scenario analysis (6-step process)

The TCFD recommends a 6-step process for using scenario analysis, outlined below:

(Step 1) Establish governance - Ensure there is a process in which scenario analysis can sit within the organisation.

- Identify all relevant stakeholders and define their responsibilities. Engaging different departments helps to source the necessary skills (e.g., a finance team may be able to support with quantification of data) and ensures the scenarios are relevant to the entire company.

(Step 2) Assess materiality of climate-related risks - Identify climate-related risks and opportunities that are material to your company. The TCFD provides a helpful categorisation of risks and opportunities:

- Risks (split between transition and physical risks): Policy and Legal (transition); Technology (transition); Markets (transition); Acute (physical); Chronic (physical).
- Opportunities: Resource Efficiency; Energy Source; Products and Services; Markets; Resilience.

(Step 3) Identify and define a range of scenarios - Select scenarios that can be used to test how risks and opportunities may develop in the future.

- Guidance published by the Network for Greening the Financial System (NGFS) suggests that organisations need to have three different temperature outcomes.
- Though there are various scenarios that can be used, the NGFS Climate Scenarios are the closest to a global standard and are aligned with scenarios that are produced by the IPCC and the IEA.
- Companies will have to make their own assumptions and adapt scenarios to ensure they are relevant to their business. These assumptions should be reflected in their company disclosures.

(Step 4) Evaluate business impacts

(Part 1) Conduct a qualitative likelihood and impact assessment.

- A qualitative likelihood and impact assessment can help companies understand how a risk, under certain conditions -could move from low likelihood, low impact, to high likelihood, high impact over time.

(Part 2) Financial impact assessment & modelling.

- Many companies and the financial sector are struggling with quantification and this remains one of the biggest challenges in managing climate risks.
    - Ensuring participation from your financial teams will be critical at this stage.

(Step 5) Identify potential responses - Decide how your business will/would adapt to these potential scenarios and risks.

- Engage with suppliers to carry out detailed scenario analysis and mitigation planning.

(Step 6) Document and disclose - Once you have undertaken scenario analysis, decide which findings you will share with your stakeholders.

- Try to establish partnerships with peers in your company's industry to set benchmarks that can be used to improve consistency and comparability within the sector.
- For companies that have concerns regarding whether certain business information related to their scenario analysis is confidential, the Task Force suggests a stepwise approach. For example, a company may begin disclosing broader, qualitative information and move to more granular, quantitative data and information over time.

Resources

Guidance on Scenario Analysis for Non-Financial Companies – This guidance document provides a practical, process-oriented way for businesses to use climate-related scenario analysis. It builds on the TCFD's 2017 *Technical Supplement* on *The Use of Scenario Analysis in Disclosure of Climate-related Risks and Opportunities.*

Guide to Climate Scenario Analysis for Central Banks and Supervisors – This guide provides practical advice on using scenario analysis to assess climate risks to the economy and financial system.

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