Reporting on climate risks and opportunities

A PRACTICAL GUIDE TO THE RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES
This year many businesses will start to experience a step change in investor expectations around environmental, social and governance (ESG) reporting, particularly in relation to the potential impacts of climate change. This follows the publication in June 2017 of the final recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), which set out a clear and consistent framework for company reporting on the issue. As of April 2018, some 250 organisations from around the world have expressed support for the TCFD recommendations, including many of the world’s largest listed companies, asset managers, pension funds, insurers, banks, ratings agencies and accounting firms.

Given the momentum behind the TCFD recommendations, ICAEW and the Carbon Trust co-hosted a breakfast briefing in early 2018, in order to raise awareness of the recommendations and help companies prepare for implementation.

This publication is a follow-up to this event and is designed to provide practical guidance, in the style of FAQs, for organisations considering how best to implement the recommendations.

‘We believe that support of G20 governments and the distinctive approach adopted by the TCFD – focusing on communication of the financial impact of climate change on the reporting organisation – mean that the recommendations could act as a catalyst for significant improvement in the quality and consistency of disclosures and governance in this area.’

Dr. Nigel Sleigh-Johnson, Head of Financial Reporting, Audit and Assurance, ICAEW

‘The transition to a low carbon economy will fundamentally transform the world around us. Going through the process of understanding climate change risks and opportunities can unlock long-term business value, even for companies outside of high impact sectors.’

Hugh Jones, Managing Director, Business Services, The Carbon Trust
What was the motivation for establishing the TCFD?

In April 2015 the leaders of the G20 called on the Financial Stability Board (FSB) to explore how climate change could pose a risk to the global financial system. Understanding how required looking across two separate dimensions of risk:

• the physical risks from a changing climate, such as rising sea levels and more frequent or severe incidents of extreme weather; and

• the transition risk faced by companies in the shift to a lower carbon economy, which may include policy and regulatory changes, disruptive technologies and a shift in consumer demand.

The FSB concluded that companies were systematically under-reporting the risks they face from climate change, with the consequence that investors and regulators do not have adequate information to properly manage this uncertainty. This was considered to pose a systemic risk to global financial stability.

In response to this threat, the FSB convened an industry-led Task Force on Climate-related Financial Disclosures (TCFD), with representation from some of the world’s largest corporates, investors, banks, insurers, accountancy firms and ratings agencies. The purpose of the TCFD was to develop a common global framework for companies to report on how climate change will affect their business.

In June 2017, the TCFD published its final recommendations, setting out a clear and consistent structure for climate-related financial disclosures. This focused on encouraging companies to voluntarily provide information that would be of most practical use within markets.

‘We believe that financial disclosure is essential to a market-based solution to climate change. A properly functioning market will price in the risks associated with climate change and reward firms that mitigate them. As its impact becomes more commonplace and public policy responses more active, climate change has become a material risk that isn’t properly disclosed.’

Michael Bloomberg, Chair, Task Force on Climate-related Financial Disclosures
Mark Carney, Governor, Bank of England and Chairman, G20 Financial Stability Board
WHAT IS A PHYSICAL RISK?

When we think of the physical impacts of climate change we often consider extreme events such as hurricanes, floods, fires and droughts, but many of these can feel remote in the UK. However, smaller events can still have a significant effect.

In Spring 2018, while the arctic experienced unprecedented warm weather, the UK experienced an unexpected cold snap that the media referred to as the ‘Beast from the East’. Even though it is still too early to say whether this specific weather event can be directly attributed to climate change, it is the type of incident more likely to occur in a warming world.

This caused disruption to transport and hampered economic productivity as employees were unable to commute to work. As companies become ever more lean in their processes, it only takes small disturbances in the supply chain to create major knock on effects. Some estimates suggest that this weather may have cost the UK economy in the region of £1bn a day.

WHAT IS A TRANSITION RISK?

The imperative to replace fossil fuel use in the power and transport sectors to deal with climate change has helped accelerate efforts to reduce the costs of renewable energy and electric vehicles. This is a clear example of the shift towards a lower carbon economy. But there are many less obvious impacts.

For example, the implementation of Minimum Energy Efficiency Standards for properties in England and Wales - a part of the policy response to achieve the UK’s legally-binding climate change targets - will affect many unprepared companies.

Although landlords, property investors and lenders will be the most obviously impacted, companies in almost every sector will have to consider the energy efficiency of their premises. Those companies that have planned ahead for this regulatory change, originally brought in as part of the Energy Act 2011, are now better placed to minimise cost and inconvenience as it is introduced. Those that do not respond adequately may face regulatory consequences, disruption to operations, or even major refurbishment costs.
What are the TCFD recommendations?

The TCFD recommendations provide guidance to companies on how to report the potential financial impacts from climate change on their business. This differs from the approach taken by many businesses today that focus on reporting the impact of their organisation on the environment.

Under this recommended approach, to help investors and wider stakeholders understand how they are managing climate-related financial risks, companies should make disclosures across four key areas:

**Governance** - setting out the respective roles of the board and management team in managing risks and opportunities.

**Strategy** - identifying risks and opportunities over different time horizons and explaining how these impact strategic and financial planning.

**Risk Management** - having processes in place for managing identified risks and including these within the overall risk management framework.

**Metrics and Targets** - explaining how both climate change impact and exposure to risks are measured, setting targets and tracking ongoing progress.

The recommendations are designed to be applicable to any company in the world. By taking a financial focus they are designed to support more effective decision-making by both investors and companies.

‘The 2015 Paris climate agreement is a global agreement that commits the world to a journey to a low carbon economy. This is now an issue of economics and no longer a question of whether you believe the climate science. It has unleashed economic forces that are driving supply and demand for many industries and this transition underpins the recommendations of the Task Force.’

Russell Picot, Special Advisor, TCFD
How soon do companies need to start thinking about the recommendations?

We are only in the early phases of the implementation for the TCFD guidance, so most companies are just taking their first steps in this process. The TCFD has proposed a five-year timeframe over which voluntary disclosures will become increasingly sophisticated and consistent, as companies become more experienced and investor expectations grow.

Organisations need to understand what their investors expect to see today. There are some comparatively easy steps to take to get started. In particular, a lot of the work that companies have previously done on environmental and sustainability reporting will still be relevant to disclosing in line with TCFD guidance.

The anticipated final outcome is a financial system where climate change impacts are well-understood by both companies and investors. In this way, risks and opportunities will be appropriately priced within the market. The financial economy and real economy will then be aligned in their reckoning of climate change uncertainty.

‘It’s all about demonstrating to the market how resilient business models are to a risk that investors are concerned about, and how that might affect the future viability of the business.’

Doug Johnston, Climate Change and Sustainability Services Partner, EY
How is the TCFD different to other sustainability initiatives?

The TCFD recommendations are complementary to other initiatives providing guidance on climate-related disclosures. Some of the more prominent initiatives include standards of bodies like the Global Reporting Initiative (GRI), broader frameworks such as those developed by the Climate Disclosure Standards Board (CDSB), and disclosure platforms such as CDP (formerly known as the Carbon Disclosure Project).

One of the major features of the recommendations is disclosure of future-facing climate change scenarios. These should include an attempt to describe business impacts where global warming is successfully held well below 2°C, as well as under less optimistic mitigation scenarios. The purpose of this disclosure is to demonstrate the resilience of an organisation’s business model.

The TCFD recommends that such disclosures be included in mainstream filings. This will ensure the information reaches investors, the intended primary users of the information. It should also encourage these issues to be discussed and debated in the board room, rather than as a separate issue just considered by sustainability teams.

‘The TCFD take the perspective of the investor and focus on the impact of climate change on the company, which is different to existing sustainability reporting frameworks, which take the impact of the company on the environment as their basis.’

Ian Mackintosh, Chairman, Corporate Reporting Dialogue
How do the recommendations fit with other corporate reporting frameworks and what is being done to align them?

Many people may be worrying that TCFD will add just another dimension to their reporting, with an associated additional resource requirement. However, the TCFD is presented as a framework that will be incorporated into existing disclosures, rather than operating in parallel.

In producing the final report, the TCFD worked closely with multiple industry stakeholders in order to ensure that the recommendations were built, as far as possible, on existing frameworks. The suggested metrics have been linked to those that are already commonly used, such as the Sustainability Accounting Standards Board (SASB), GRI and CDP. The concepts and guiding principles of Integrated Reporting have also been incorporated. This is an important decision given concerns that too many initiatives are creating confusion in the market.

With this in mind, efforts are being made to align the multiple existing frameworks. One example is the Corporate Reporting Dialogue (CRD), which was set up with the objective of creating greater coherence, consistency and comparability between financial and non-financial reporting frameworks. The organisations involved in the CRD\(^1\) share information to enable alignment of some of the more prominent frameworks and express a united voice on issues of common interest.

The TCFD recommendations broadly fit with the frameworks of the CRD member organisations. However, it is recognised that there are currently some variances in metrics and some of the definitions and terminology used.

The future work programme of the CRD will continue to seek alignment between the frameworks using the TCFD recommendations as a basis. For more information about the work of the CRD, visit corporatereportingdialogue.com.

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\(^1\) There are seven participating organisations in the Corporate Reporting Dialogue. These are: CDP, CDSB, GRI, IASB, IIRC, ISO and SASB. FASB is an observer.
What are the potential benefits of implementing the recommendations?

The benefits from understanding climate-related opportunities and risks will depend on the exposure of a business model to climate change impacts. For example, investors in organisations with business models dependent on fossil fuel use are already concerned that regulatory changes and shifts in consumer demand could lead to ‘stranded assets’. The long term value and competitive advantage could be significant for companies that can shift their current strategy and better mitigate future disruption from the physical impacts of extreme weather, successfully manage a transition to cleaner technologies, and/or develop sustainable business models.

Support for the recommendations will be a clear market signal to investors and analysts that the company is taking leadership action on ESG and encouraging confidence in its competitiveness and resilience.

As a company continues to improve its disclosure, a broad group of stakeholders will need to be engaged across the organisation and the supply chain, strengthening relationships and building common understanding. An increased focus on these issues might also unlock innovation through identifying how more sustainable products or services can be monetised, or highlighting areas where the greatest marginal gains can be achieved through improved sustainability.

Meeting investor expectations for high quality climate-related financial disclosures may ultimately lead to greater confidence in a business and enhanced access to capital, while also cementing climate change discussions more firmly in the board room. Suffice to say, simply providing a boilerplate response that does not give specific and meaningful information to investors will fail to capture any of these potential benefits.

‘The statement of long-term strategy is essential to understanding a company’s actions and policies, its preparation for potential challenges, and the context of its shorter-term decisions. Your company’s strategy must articulate a path to achieve financial performance. To sustain that performance, however, you must also understand the societal impact of your business as well as the ways that broad, structural trends – from slow wage growth to rising automation to climate change – affect your potential for growth.’

Larry Fink, Chairman and CEO, BlackRock, Inc.
I’m interested. What are the next steps to take?

Companies can find the final recommendations report on the TCFD website (www.fsb-tcfd.org), which is provided alongside an annex on implementation.

Some of the key questions that an organisation will need to answer when going through the early stages of understanding and reporting on climate-related risks and opportunities are set out below.

- What relevant climate-related information does your company already disclose?
- How do you manage communication between your sustainability, finance, strategy and risk management functions in order to gather relevant information?
- To what extent are long term climate change considerations already taken into account at board level?
- Have you engaged with relevant industry peers and trade associations to look at common expectations and best practice for disclosures?
- Can you make use of any other relevant internal resources, such as materiality assessments?
- How can you map your existing sustainability strategy onto longer term risks and opportunities, to show that work is in progress?
- Who is best placed to manage the climate-related financial disclosure process within the organisation?

The TCFD also recommends that some sectors should go through a scenario analysis process, for which a technical supplement is provided with practical guidance. Although, for sectors where this scenario analysis approach is not specifically recommended, it is still possible to move from a qualitative to a quantitative understanding of climate risks and opportunities.

‘The TCFD recommendations and guidance will evolve into a board-level strategic tool to develop, implement and communicate how your business will manage its climate-related financial risks and opportunities, protecting and building long term business value. But we are still in the early days, so there is little standardisation. An important aspect is to broaden the dialogue with your investors.’

Hugh Jones, Managing Director, Business Services, The Carbon Trust
Are there examples of best practice to refer to?

While the TCFD’s final recommendations were only recently published in 2017, there are some good examples of best practice emerging from FTSE 100 companies.

The ‘Climate Change’ section of *Anglo American’s 2017 Annual Report* includes specific information about strategy, including the financial impact of governmental efforts to limit climate change and the impact that transitioning to a low carbon world will have on product demand. These disclosures are supported by case studies later in the report.

The disclosures in *Diageo’s 2017 Annual Report*, while not specifically structured around the TCFD’s four categories, clearly identify and explain how climate change could lead to greater scarcity of water, an essential resource for its products. These disclosures are included as part of the ‘Sustainability and Responsibility Review’. The Strategic Report also includes a useful map that sets out ‘Diageo sites located in water-stressed areas’.

The Strategic Report in *HSBC’s 2017 Annual Report* includes a clear and coherent table which follows the TCFD recommended disclosure, as set out in Figure 4 of the TCFD guidelines.

Given that the TCFD recommendations broadly align with many existing frameworks, it is also worth referring to examples of companies currently producing effective climate-related disclosures. Some commonly cited examples of good practice in relation to scenario analysis include Westpac, BHP Billiton and Statoil.
How do I get more information?

For information about the Task Force, the recommendations and upcoming events, visit https://www.fsb-tcfd.org/.

An ICAEW webinar recording, providing a detailed overview of the TCFD report and guidance on implementation, is available at www.icaew.com/TCFDwebinar. The webinar was co-hosted with the TCFD and presented by Russell Picot, Special Advisor to the TCFD.

For more information on how the Carbon Trust can help your organisation with implementing and reporting against the TCFD recommendations, visit www.carbontrust.com/tcfd.
THE CARBON TRUST

The Carbon Trust is an independent, expert partner of leading organisations around the world, helping them contribute to and benefit from a more sustainable future through carbon reduction, resource efficiency strategies and commercialising low carbon technologies. With a mission to accelerate the move to a sustainable, low carbon economy, the Carbon Trust has a team of over 30 different nationalities, based in the UK, China, Mexico, Brazil, India, South Africa and the USA.

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