Task Force on Climate-related Financial Disclosures

A ShareAction Briefing for MPs (November 2020)

The Intergovernmental Panel on Climate Change (IPCC) warns that averting the most serious consequences of climate change requires a radical overhaul of the global economy[1]. For the financial services sector, this means accounting for the material implications of climate change which have devastating long-term impacts on people and the planet. However, persistent short-termism means that financial organisations are not incentivised to take this into account.

The Financial Stability Board's Task Force on Climate-related Financial Disclosure (TCFD) provides the first industry-driven reporting framework enabling financial sector stakeholders to account for the financial impact of climate change on businesses and take action to address this. This briefing aims to explain what TCFD is, how it works, the current state of play and the future outlook.

What is TCFD?

TCFD is a voluntary reporting framework which prioritises the disclosure of decision-useful, forward looking information on the financial risks and impacts of climate change on businesses in the financial sector and non-financial sector.

Its recommendations aim to foster understanding of the material implications of climate change, potentially enhancing companies' risk management and structure planning processes, promoting more informed investment decisions and contributing to stable and resilient capital markets.

Why is TCFD relevant?

Climate change presents a material, transitional and legal risk to financial assets that must be accounted for. Research suggests that capital market assets are already losing value as a result of climate change[2], as markets continue to misprice climate-related risks which will manifest within timescales relevant to all investors[3]. Meanwhile, a global transition to a low-carbon, climate resilient economy is underway.

1 IPPC (2018). Special Report: Global Warming of 1.5C Summary for Policymakers. https://www.ipcc.ch/site/assets/uploads/sites/2/2019/05/SR15_SPM_version_report_LR.pdf
2 Steele, G. (2020). Confronting the 'Climate Lehman Moment': https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3542840
3 Reynolds, F. (2019) Financial markets are mispricing climate risk. https://www.unpri.org/pri-blog/financial-markets-are-mispricing-climate-risk/5135.article

Separate guidance was prepared for financial sector stakeholders, including banks, insurance companies, asset owners and asset managers. Such stakeholders need to assess how the long-term strategies and capital allocation of businesses are pricing-in the financial impacts of climate change and are preparing for operation in a low-carbon economy. TCFD provides a framework that facilitates an effective, clear and consistent disclosure of how this is being managed through the assessment of the climate-related risks and opportunities to which businesses are exposed.

Several national regulatory bodies and other influential organisations have shown varying degrees of support for the TCFD framework[4]. In July 2019 the UK Government's Green Finance Strategy set expectations that all listed companies and asset owners disclose in line with the recommendations by 2022.

How does TCFD work?

TCFD develops recommendations for more effective climate-related disclosures around four areas representing core elements of how businesses operate. These areas include governance, strategy, risk management and metrics and targets[5].

Disclosures in these areas inform expectations of how climate-related issues may affect a company's financial performance under different climate-related scenarios, including a 2ºC scenario.

This may result in better risk management and more informed strategic planning by financial stakeholders, as they seek to mitigate the financial impact of climate-related risks and maximise climate-related opportunities.

Case study: Landsec

The largest commercial and property development company in the UK has adopted TCFD recommendations since 2017.

TCFD reporting has enabled consistent risk assessments ensuring resilience from the physical risks from climate change, such as flooding and windstorms.

It has also supported investment in reducing contribution to climate change, reaching nearly halfway towards 2030 energy reduction targets, with over £4m of avoided costs for customers[6].

4 IPE (2018). Carbon: Task Force sets the tone on reporting. https://www.ipe.com/carbon-task-force-sets-the-tone-on-reporting/10023441.article
5 TCFD (2020). Taskforce on Climate-related Financial Disclosures: Overview. https://www.fsb-tcfd.org/wp-content/uploads/2020/03/TCFD_Booklet_FNL_Digital_March-2020.pdf
6 Landsec (2019). Annual Report 2019, p.192. https://landsec.com/sites/default/files/2019-06/Landsec_AR2019_Final_for_web.pdf

The TCFD recommends...

Governance

Disclosure of an organisation's governance around climate-related risks and opportunities.

Strategy

Disclosure of the actual and potential impacts of climate-related risks and opportunities on an organisation's strategy and financial planning.

Risk management

Disclosure of how an organisation identifies, assesses and manages climate-related risks.

Metrics and Targets

Disclosure of the metrics and targets used to assess and manage climate-related risks and opportunities.

Where are we now with TCFD?

The Department of Work and Pensions (DWP) has shown real leadership as the first UK Government department to require entities within its remit to publicly report on how they are managing the financial risks of climate change. The Pension Schemes Bill will enable DWP to introduce TCFD disclosure requirements for trustees of large occupational schemes in relation to climate-related risks and opportunities.

The proposal means that more than 75% of pension scheme assets will be subject to these mandatory TCFD-aligned requirements[7]. Given that pension assets total $2.9 trillion (102% of UK GDP)[8], this will mobilise the substantial size and influence of the pension industry to take the necessary action to mitigate climate risks and play a progressive role in helping the UK meet its climate commitments.

However, TCFD implementation from other financial actors is inconsistent and insufficient. 73% of asset managers have publicly supported the Task Force recommendations but only one-fifth have published a TCFD report[9]. The quality of TCFD-aligned reporting varies considerably between asset managers and few provide comprehensive disclosures on all requirements. To incentivise investors to take consistent action to mitigate climate risks, mandatory TCFD disclosures for asset managers, companies and asset owners need to be introduced.

7 HSF (2020). DWP turn up the heat on climate risk requirements for UK pension schemes. https://hsfnotes.com/pensions/2020/09/02/dwp-turns-up-the-heat-on-climate-risk-requirements-for-pension-schemes/

8 TAI (2019). Global Pension Assets Study 2019, p.23. https://www.thinkingaheadinstitute.org/-/media/TAI/Pdf/Research-Ideas/GPAS_2019_final. pdf?modified=20190208104038

9 SA (2020). Point of No Returns, p.37-39. This report surveyed 75 of the world's largest asset managers. https://shareaction.org/wp-content/uploads/2020/03/Point-of-no-Returns.pdf

TCFD's next steps

Voluntary uptake of TCFD has been slow, and mandatory reporting is being implemented in piecemeal fashion. The Department for Business, Energy and Industrial Strategy are considering implementation and the Financial Conduct Authority (FCA) is consulting on its application to premium listed companies[10], large asset management firms and FCA regulated pension schemes[11]. However, for other sections of the economy, such as banks and asset managers, there is little action.

TCFD must apply to all sectors to be effective, and mandatory requirements to disclose against TCFD would drive better quality disclosure on a much faster scale. It would allow investors to better price and respond to climate risk in their investments. However, this requires a joined-up approach from government and regulators, and this remains one of the biggest obstacles to an effective and efficient reporting regime in the UK.

TCFD-aligned reporting is a necessary first step for transparent climate-related financial risk disclosure, but it is not sufficient. To ensure the UK reaches net-zero by 2050, it is crucial that all financial sector stakeholders align with the Paris Agreement. Our recommendation is that policymakers put pressure on the Government to require companies and investors to align with the Paris Agreement goal by 2050.

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10 FCA (2020). Proposals to enhance climate-related disclosures by listed issuers. https://www.fca.org.uk/publication/consultation/cp20-3.pdf
11 ELN (2020). FCA to introduce landmark climate risk reporting in 2022. https://www.energylivenews.com/2020/10/05/financial-conduct-authority-to-introduce-landmark-climate-risk-reporting-in-2022/

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