Institute for Sustainable Finance

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SUSTAINABLE FINANCE PRIMER SERIES:

Climate-Related Financial Disclosures

WHAT IS THE TASK FORCE FOR CLIMATE-RELATED DISCLOSURES (TCFD)?

The Task Force for Climate-related Financial Disclosure (TCFD) is an industry-led entity that was created in 2015 by the Financial Stability Board (FSB) to provide information to improve financial processes such as investment, lending and insurance underwriting. The FSB undertook a review, at the behest of the G20 Finance Ministers, to determine how the financial sector could better integrate climate-related issues into its decision-making and operating processes. In June 2017, the Task Force issued its framework for climate-related financial disclosures.

WHAT THE TCFD'S MAIN RECOMMENDATIONS?

Its key features are that such disclosures should be adaptable by all organizations, included in financial filings, designed to provide meaningful forward-looking information, and have a strong emphasis on risks and opportunities related to a transition to a lower-carbon economy.

The four overarching elements of the disclosures include :

1. **governance** – describe the roles of the Board and management in dealing with related opportunities and risks;
2. **strategy –** examine the actual and potential impact on the organization's businesses, strategy and financial planning;
3. **risk management –** the processes used to identify, assess and manage associated risks; and,
4. **metrics and targets –** used to assess and manage climate-related risks and opportunities.

The recommendations emphasize the disclosure of financial estimates and the resilience of organizations to various climate-related scenarios.

HAVE THE TCFD RECCOMMENDATIONS BEEN WIDELY ADOPTED GLOBALLY?

At present, adoption of the TCFD recommendations is **voluntary** in most jurisdictions; although momentum is building to make it mandatory in numerous jurisdictions around the globe. For example, both New Zealand and the U.K. recently implemented plans to phase in mandatory TCFD reporting, while other countries are engaged in processes reviewing the possibility of doing so. In September 2020, over 1,500 organizations globally were official TCFD supporters, an increase of 85 percent over the previous 15 months. Supporters included 1,340 companies with a total market capitalization of $12.4 US trillion, and financial institutions (FIs) responsible for over $150 US trillion, including Climate Action 100+, which represents over 500 investors managing over $47 US trillion.

The global central banks' Network for Greening the Financial System (NGFS) provided support for the TCFD and called for "achieving robust and internationally consistent climate and environment-related disclosures" in an April 2019 report.

Adoption of TCFD standards is also included in the EU Technical Expert Group on Sustainable Finance recommendations in January of 2019, while comparable requirements have been mandatory for large issuers and financial institutions (FIs) in France for several years now.

WHY HAS THIS ISSUE GAINED SO MUCH ATTENTION?

Much of the impetus for improvements in disclosures has come from investors, particularly institutional investors. This is because they need information that is reliable, consistent and comparable to properly assess investment opportunities and risks. As the NGFS noted in its April 2019 report, robust disclosures will help support the functioning of capital markets by improving market pricing mechanisms and risk management processes, and by enhancing the ability of market participants to identify investment and lending opportunities.

The fact that FIs responsible for over $150 US trillion are TCFD supporters demonstrates that much of the impetus for improvements in disclosures has come from FIs, particularly institutional investors. In line with this global phenomenon, it is noteworthy that a 2019 survey of TSX-listed companies, the Canadian Securities Administrators (CSA) found that 22% of the firms surveyed provided no climate-related disclosures, while another 22% provided mere "boiler plate" disclosures.

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WHAT ARE THE HURDLES TO DISCLOSURES?

Climate-related risks are commonly categorized as:

- physical risks, arising from both acute and chronic climate changes; and
- transitional risks, such as reputational, regulatory and policy risks, among others.

One of the central issues is that providing such disclosures is complicated by nature, since it is difficult to predict the future path of climate change, as well as the timing and impact of climate-related events. Therefore, the corresponding fallout is uncertain. As a result, companies struggle with the analysis needed to estimate financial impacts of various climate warming scenarios.

Organizations have noted several specific barriers in attempting to provide TCFD disclosures, ranging from a lack of available data or expertise to associated legal risks. In its April 2019 update, the TCFD noted that many companies faced confidentiality issues when dealing with required disclosures related to strategy. The TCFD also found that among those firms adopting the recommendations, more clarity was needed on the financial impact of various scenarios and the resilience of organizational strategy to such changes.

WHAT'S HAPPENING IN CANADA?

To date, there are no formal requirements for Canadian organizations to provide TCFD-consistent disclosures. As of December 2020, there were 73 Canadian TCFD supporters. This included 49 FIs, 18 non-financial firms, as well as two government and four other organizations.

The high ratio of financials supporting TCFD is consistent with their strong need for such information. This sentiment is highlighted in the recent announcement by Canada's eight largest pension funds, responsible for over $1.6 trillion in assets, who issued a joint statement calling for better environmental, social and governance (ESG) and climate-related financial disclosures, supporting both the Sustainability Accounting Standards Board (SASB) and TCFD frameworks.

In its 2019 Spring Financial System Review, the Bank of Canada identified climate change as one of six key system vulnerabilities, and referenced the NGFS recommendation for disclosures. In August 2019, the CSA prepared general guidance for Canadian-listed companies regarding "Reporting of Climate Change-related Risks."

The June 2019 Canadian Expert Panel Final Report contained a similar message on the importance of companies providing such disclosures. The expert panel called for a "comply or explain" approach to implementing TCFD recommendations. They recommend a gradual approach of two phases, with phase one being implemented within three years for large issuers and FIs, and phase two within five years (with smaller firms being granted an additional two years to implement each phase).

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