ClientEarth response to consultation

Recommendations of the Task Force on Climate-related Financial Disclosures

9 February 2017

1 Introduction

On 14 December 2016, the Task Force on Climate-related Financial Disclosures (**TCFD**) issued its draft recommendations for helping businesses disclose climate-related financial risks and opportunities (**TCFD Report**). The TCFD has launched a 60 day public consultation period, which closes on 12 February 2017 (**Consultation**).

ClientEarth is providing a formal submission to the Consultation via the online form. In addition, this document sets out ClientEarth's general comments and key concerns in response to the TCFD Report and in support of its formal submission.

ClientEarth is a non-profit environmental law organisation based in London, Brussels and Warsaw. We are environmental lawyers working at the interface of law, science and policy. Using the power of the law, we develop legal strategies and tools to address major environmental issues. ClientEarth's Company & Financial Project conducts research into the legal implications of climate-related financial risk for a wide spectrum of market participants including companies, investors (including pension funds), company directors and regulators. We also engage with, and conduct advocacy to, these stakeholders in relation to the specific and systemic risks of climate change.

2 General comments

ClientEarth broadly supports the majority of the recommendations contained in the TCFD Report. The strength of the TCFD Report is that it can provide authoritative, industry-led guidance on what constitutes effective disclosure about climate-related risks and opportunities for business. We strongly welcome this attempt to build consensus and to establish consistent expectations across industry, the FSB and the G20.

ClientEarth does however have a number of concerns about the TCFD Report in its current form. These concerns primarily relate to the way in which the TCFD has represented the current legal and regulatory landscape, and the extent to which organisations can be held accountable for their disclosures. In summary, our key concerns are that:

1. the TCFD Report is potentially confusing about existing mandatory legal duties to report climate-related risks;

2. the TCFD Report currently misstates the objectives of the Paris Agreement; and

3. the TCFD Report should be more prescriptive about requirements to publish assumptions relating to scenario analyses.

We have set out our position in relation to each of these key concerns below. Where applicable, we have also included examples of how the text of the TCFD Report could be amended to address our concerns.

3 Key concerns

3.1 The TCFD Report is potentially confusing about existing mandatory legal duties to report climate-related risks

Throughout the work of the TCFD, both the FSB and the TCFD itself have consistently emphasised that the TCFD's recommendations about climate-related financial disclosures will be voluntary in nature.[1] Indeed, the TCFD Report states that the TCFD's remit was to devise a 'principle-based framework for voluntary disclosure'.[2] Given that the TCFD is not a law making body, this makes sense. This language however is potentially very confusing for organisations with existing disclosure obligations. While adoption of the specific recommendations in the TCFD Report may be voluntary, disclosure of material climate-related risks is not.

In many G20 jurisdictions, mandatory legal obligations already exist which require companies and financial institutions to disclose material risks in their financial filings or annual reports. This includes material climate-related risks.

In the UK for example, companies are already required to provide 'a fair review of the company's business',[3] including a proper account of 'the main trends and factors likely to affect the future development, performance and position of the company's business';[4] and a proper 'description of the principal risks and uncertainties facing the company'.[5] As reflected in current practice, for many companies this includes disclosure of climate-related risks. Similarly, in the US, the Securities and Exchange Commission has issued interpretive guidance clarifying the types of climate-related information that US public companies are required to disclose in their 10-K filings.[6]

While sections of the TCFD Report do acknowledge these existing legal obligations,[7] other parts of the report appear to suggest that it remains up to individual organisations to decide what and how to disclose.[8] It is not. Organisations must comply with the mandatory legal disclosure requirements in each jurisdiction applicable to their operations. As the current shareholder-led

[1] FSB, 'Proposal for a disclosure task force on climate-related risks' (9 November 2015), www.fsb.org/wp-content/uploads/Disclosure-task-force-on-climate-related-risks.pdf.
[2] TCFD, 'Recommendations of the Task Force on Climate-related Financial Disclosures' (4 December 2016), 3.
[3] Companies Act 2006 (UK), s 414C(2)(a).
[4] Ibid, s 414C(7)(a).
[5] Ibid, s 414C(2)(b).
[6] US Securities and Exchange Commission, 'Commission Guidance Regarding Disclosure Related to Climate Change' (8 February 2010)
[7] TCFD, 'Recommendations of the Task Force on Climate-related Financial Disclosures' (4 December 2016), 35.
[8] See e.g. TCFD, 'Recommendations of the Task Force on Climate-related Financial Disclosures' (4 December 2016), 7; and 42, Figure 11.

lawsuit against Exxon demonstrates, failure to do so is already leading to high profile and damaging litigation.[9]

While we strongly support the TCFD's assertion that climate-related risks are material risks for many organisations and its recommendation that climate-related disclosures be included in mainstream financial filings, in many cases this requires an assessment of what information is or isn't 'material' or amounts to a 'line-item' disclosure.[10] This assessment needs to be carried out in accordance with the relevant jurisdiction specific requirements.

To avoid undermining organisations' compliance with their existing legal obligations, the TCFD Report should make it clearer that many G20 countries already require the disclosure of climate-related risks in mainstream financial filings and corporate reports. Additionally, the TCFD Report should make it clear that organisations should obtain their own legal advice about their existing disclosure obligations, in each jurisdiction in which they operate, along with how these might intersect with the TCFD recommendations.

We have included below some possible changes that the TCFD may wish to consider to clarify this point. There may well be other changes required to ensure the point is consistent throughout the TCFD Report.

After the second paragraph of page iii in the Executive Summary, insert a footnote with the following text:

- *It should be noted that climate-related risk disclosure is already mandatory under the laws of many G20 countries.*

After the first sentence in paragraph 2 on page 3, insert the following text:

- *Therefore, many companies are already required under existing laws to disclose climate-related financial risks, although this appears to be poorly understood or complied with. Organisations should obtain their own legal advice about their existing disclosure obligations, in each jurisdiction in which they operate.*

After the word 'emerged' in the first sentence of paragraph 2 on page 7, insert the following text:

- *, and that organisations may already be subject to existing disclosure laws and regulations*

Amend the section titled 'Location of Disclosures and Materiality' on page 35, to make it clearer that organisations will need to obtain their own independent legal advice about how existing disclosure requirements intersect with TCFD recommendations.

References throughout the TCFD Report to 'voluntary climate-related disclosures' should also be reviewed for consistency.

[9] See ClientEarth, 'Exxon faces climate disclosure lawsuit – from its own investors' (10 November 2016) http://www.clientearth.org/exxon-faces-climate-disclosure-lawsuit-investors/
[10] See TCFD, 'Recommendations of the Task Force on Climate-related Financial Disclosures' (4 December 2016), 35.

We also note that the summary of current disclosure frameworks contained in Appendix 3 of the TCFD Report could be significantly more comprehensive. At the moment this information focuses more on disclosure of greenhouse gas emissions and related environmental metrics, rather than on risk reporting requirements which exist in each jurisdiction (which where relevant should cover climate-related risk).

Including more detailed information here would greatly assist with illustrating the point that many jurisdictions require disclosure of material risks (which, where relevant, should cover climate-related risk) in their financial filings or annual reports. In particular we would recommend that the summary of disclosure frameworks should include the following examples.

UK	S414C Companies Act 2006 sets out content requirements for the strategic report. Quoted companies (as defined in the Act) must disclose: • 'a fair review of the company's business'; • 'a description of the principal risks and uncertainties facing the company'; • 'the main trends and factors likely to affect the future development performance and position of the company's business'; and • 'information about environmental matters (including the impact of the company's business on the environment)'. Each of these heads of information can require the reporting of climate-related risk where relevant to the company.
EU	The Transparency Directive (2004/109/EC) requires public companies to publish a management report each year. Further requirements for the management report are set out in the Accounting Directive (2013/34/EU) (as amended by the Non-Financial Reporting Directive (2014/95/EU)). The management report shall include: • 'a fair review of the development and performance of the undertaking's business and of its position' and • 'a description of the principal risks and uncertainties that it faces'. If necessary to understand the company's development, performance or position, this information shall include financial and (where appropriate) non-financial key performance indicators, including information relating to environmental matters. Therefore environmental matters (including climate-related risk) related to the business must be disclosed, if this is necessary for an understanding of the company's development, performance or position. The management report must also give an indication of the company's likely future development.

We recommend that further information on risk reporting requirements (which, where relevant, should cover climate-related risk) for other jurisdictions also be included in Appendix 3.

3.2 The TCFD Report currently misstates the objectives of the Paris Agreement

Article 2 of the Paris Agreement commits 195 member nations to the goal of 'holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels'.[11]

The TCFD Report reproduces this statement in its first paragraph. However, the section on scenario analysis (which forms a key part of its recommendations) then recommends that organisations use a 2°C scenario when conducting scenario analysis. The TCFD Report explains that a 2° scenario is one 'which which lays out a pathway and an emissions trajectory consistent with holding the increase in the global average temperature to 2°C above pre-industrial levels'.[12] It then states that such a 2°C scenario 'provides a common reference point that is aligned with the objectives of the Paris Agreement'.[13] This language is replicated in the Technical Supplement on the use of Scenario Analysis in Disclosure of Climate-Related Risks and Opportunities, which accompanies the TCFD Report (**Technical Supplement**).[14]

The statement that the use of a 2°C scenario will provide a reference point that is aligned with the Paris Agreement is incorrect. To be properly aligned with the objectives of the Paris Agreement, a scenario analysis would need to apply a pathway and an emissions trajectory consistent with holding the increase in the global average temperature to '**well below** 2°C above pre-industrial levels' and which pursues efforts to 'limit the temperature increase to 1.5°C above pre-industrial levels'.

In its section on 'Key Issues Considered and Areas for Further Work', the TCFD Report does appear to acknowledge this inconsistency. It notes that there is a need to '[f]urther develop applicable 2°C (or lower) transitions scenarios'.[15] Failure by organisations to align their strategic planning and reporting in line with the true objectives of the Paris Agreement represents a business risk which companies may need to disclose.[16]

Accordingly, the TCFD Report should be clear about what is necessary for a scenario analysis to properly align with the objectives of the Paris Agreement and clearly state any current practical limitations in information and data that may need to be improved in order to do so. The TCFD should make it explicit that, in order to align their strategies and disclosures with the Paris Agreement, organisations will ultimately need to use a 1.5°C/well below 2°C scenario.

In this regard, IPCC AR5 already proposes carbon budgets for scenarios consistent with a <1.5˚C and 'well below' 2˚C emissions pathway. As the TCFD Report also notes in a footnote, the IEA is developing a 1.5°C scenario which will become available in June 2017.

[11] United Nations Framework Convention on Climate Change, "The Paris Agreement," December 2015, http://unfccc.int/files/essential_background/convention/application/pdf/english_paris_agreement.pdf.
[12] TCFD, 'Recommendations of the Task Force on Climate-related Financial Disclosures' (4 December 2016), 29.
[13] Ibid.
[14] TCFD, 'Technical Supplement: The Use of Scenario Analysis in Disclosure of Climate-related Risks and Opportunities (14 December 2016), 17.
[15] TCFD 'Technical Supplement: The Use of Scenario Analysis in Disclosure of Climate-related Risks and Opportunities (14 December 2016), 34, 37.
[16] See Jonathan Church, "2 degrees" must not become shorthand for the Paris Agreement', Business Green (14 January 2016) http://www.businessgreen.com/bg/opinion/2441679/-2-degrees-must-not-become-shorthand-for-the-paris-agreement

We have included below some possible changes that the TCFD may wish to consider to clarify this point. There may well be other changes required to ensure the point is consistent throughout the TCFD Report.

In paragraph 1 on page 28, delete the following text:

- *aligned with the objectives of the Paris Agreement*

At the end of paragraph 1 on page 28, insert the following text:

- *In order to align their business strategy and corresponding disclosures more closely with the objectives of the Paris Agreement, organisations should also use a <1.5˚C and 'well below' 2˚C emissions pathway when available. In this respect, the IEA is currently developing a 1.5°C scenario which will become available in June 2017.*

In the Technical Supplement, include a clear statement about what is necessary for a scenario analysis to properly align with the objectives of the Paris Agreement and clearly state any current practical limitations in information and data that may need to be improved in order to do so.

3.3 The TCFD Report should be more prescriptive about requirements to publish assumptions relating to scenario analyses

ClientEarth strongly endorses the TCFD's recommendation that organisations disclose potential impacts of climate-related risks and opportunities on an organisation's businesses, strategies, and financial planning under different potential future scenarios.[17]

Scenario analysis can provide an effective means of providing this information. However, in order to align with TCFD's own stated principles of consistency, comparability, and reliability, the TCFD Report should be more prescriptive about requiring organisations to publish the assumptions underpinning the scenarios they use.

Currently, the TCFD Report recommends that organisations 'use a 2°C scenario in addition to two or three other scenarios most relevant to their circumstances, such as scenarios related to Nationally Determined Contributions (NDCs), business-as-usual scenarios, or other challenging scenarios.'[18] The TCFD Report then qualifies this recommendation by suggesting that organisations that have little experience implementing scenario analysis disclose only qualitatively how the organisation's strategy and financial plans may be affected under relevant climate change scenarios; and suggesting that organisations with significant 'climate-related exposure', '*strive* to disclose' a greater range of elements, including key assumptions underlying each scenario and information about the conclusions drawn from scenario analysis, including both qualitative and quantitative information.

By recommending that organisations self-select particular scenarios 'relevant to their circumstances', and allowing some organisations to selectively provide the assumptions they

[17] Ibid, 27.
[18] TCFD, 'Recommendations of the Task Force on Climate-related Financial Disclosures' (4 December 2016), 29.

use, the TCFD Report may risk undermining its own objectives. If different organisations make disclosures based on different scenarios, the resulting information will be inconsistent and difficult to compare. While we understand that this may be a trade-off while some organisations develop their scenario analysis capacity, it should not excuse them from publishing the assumptions. If the assumptions used to develop the scenarios are not published along with the conclusions of the scenario analysis, the resulting information will be of minimal utility for the market and may be potentially misleading.

Accordingly, the TCFD Report should be more prescriptive about its recommendations that organisations publish the assumptions underpinning their scenario analyses. The TCFD should also not qualify the recommendation that organisations with more significant exposure to climate-related issues only '*strive* to disclose' key aspects of their scenario analysis, including assumptions. [19] This should be a basic expectation.

[19] TCFD, 'Recommendations of the Task Force on Climate-related Financial Disclosures' (4 December 2016), 30.