

1 May 2016

Task force on climate-related financial disclosures

Dear task force members,

We are writing on behalf of three international investor groups focused on investment risks and opportunities related to climate change. Our organizations represent 304 long-term investors with over \$30 trillion U.S. dollars of assets under management: the Institutional Investors Group on Climate Change (IIGCC, Europe), the Ceres Investor Network on Climate Risk (INCR, North America) and the Investor Group on Climate Change (IGCC, Australia and New Zealand), which together form the Global Investor Coalition on Climate Change.

We read with great interest your Phase I report and appreciate the opportunity to provide our response to your public consultation. We particularly appreciate that the report discusses key principles of disclosure, transition risks to companies, and materiality; and is focused on investors as a key audience for disclosures. We stress that the principle of prudence should form a core part of disclosure principles, in line with existing regulation. Long-term capital preservation and good stewardship should guide the work. As we discussed in our March 25, 2016 letter, we believe you can play a critical role in addressing the needs of investors and other financial market participants for meaningful disclosure of climate-related financial risks facing companies.

We would like to highlight several aspects of our submission. Investors are concerned that companies are generally not making decisions that fully consider the need for a rapid transition to a low carbon economy, boards and management do not fully integrate climate risks and opportunities into their strategies, and disclosure on all of these issues is inadequate. These items, plus the incompleteness of most corporate greenhouse gas emissions reporting, significantly impedes investors' abilities to assess climate risks.

As discussed in our submission, there are a range of key strategies to address these deficiencies, which we hope you will carefully consider. These include:

- (1) Companies are generally not making decisions that fully consider a rapid transition to a lower carbon economy. Investors need disclosure of 2 degree stress testing and absolute emissions reduction targets, as well as on the resilience of the company's strategy with regard to CAPEX plans, portfolio composition and R&D.
- (2) Boards and management do not fully integrate climate into their strategies. This can be addressed with the climate risk management and disclosure approach in the March 25, 2016 GIC letter to the task force (globalinvestorcoalition.org/see-gic-letter-tcfd/).
- (3) Narrative reporting which allows comparisons between successive disclosures and thereby demonstrates progress is essential. Methodologies should be comparable across years.

We also support greater disclosure of portfolio climate risks by investors. This would be facilitated by improved corporate disclosure as well as a better understanding of the risks and opportunities inherent in other asset classes. Methodologies and tools for investor disclosure are still nascent and therefore should be non-prescriptive in order to enable innovation and the emergence of best practice.

While we have seen some progress towards the integration of climate risk disclosure into financial filings, much work remains to be done. Our submission also discusses barriers to integration, ways of overcoming those barriers, and measures of success for evaluating the impact of your work in 2017 and beyond.

Response to Public Consultation:

COVERAGE AND AUDIENCES

1. Which types of nonfinancial firms should any disclosure recommendations cover? List in order of importance.

1. Energy (equipment, services, oil, gas etc.)
2. Utilities (electric, gas, renewables, water)
3. Industrials (capital goods, commercial services, transport)
4. Materials (chemicals, construction, metals & mining, paper & forest, etc.)
5. Consumer Discretionary (auto, durables, retailing, etc.)
6. Information Technology (semiconductors, software, hardware, etc.)
7. Telecommunications (diversified, wireless, etc.)
8. Health Care (equipment, services, pharma, biotech, etc.)
9. Consumer Staples (food, beverage, household etc.)

2. Which types of financial firms should any disclosure recommendations cover?

Yes:

- Banks (diversified, thrifts, mortgage, etc.)
- Diversified Financials (asset management, investment banking/broker-dealer, consumer)
- Insurance (brokers, multi-line, property, reinsurance, etc.)
- Real Estate (REITS, management and development)
- Credit Rating Agencies
- Pension Funds/Schemes
- Private equity and hedge funds
- Sovereigns

No

- Investment Consultants (because they don't manage assets themselves)

We suggest that your disclosure recommendations also cover stock exchanges, given their important role in capital markets and existing efforts to encourage them to implement sustainability disclosure listing requirements or guidelines.

3. Which users in the financial sector should be considered as the target audience?

All of these:

- Investors (including insurance, asset managers, funds, pensions, etc.)
- Banks (diversified, commercial, project finance)
- Broker-Dealers and Investment Banks
- Credit Rating Agencies
- Consultants/Advisory
- Beneficiaries

CLIMATE-RISK DIMENSION

4. For nonfinancial preparers of climate risk and opportunity information, what are the top three key concerns that you would like the Task Force to keep in mind in making our recommendations?

Most companies' climate disclosures do not include enough data about aligning their businesses with limiting warming to <2 degrees. Disclosure improvements resulting from the TCFD's work should help reduce systemic risks to economies, as well as help investors and companies manage risks. It should support long-term capital preservation and good stewardship by companies and investors.

Our concerns and suggestions for addressing them:

- 1) Companies are generally not making decisions that fully consider a rapid transition to a lower carbon economy. Investors need disclosure of 2 degree stress testing and absolute emissions reduction targets, as well as on the resilience of the company's strategy with regard to CAPEX plans, portfolio composition and R&D. These disclosures must include details of the specific amounts of CAPEX allocations in absolute numbers and as a percentage of total CAPEX. In addition, it is key for 2 degree stress testing results to provide information regarding the quantitative and qualitative impacts on project types, resource types, and total earnings.
- 2) Boards and management do not fully integrate climate into their strategies. This can be addressed with the climate risk management and disclosure approach in the March 25, 2016 GIC letter to the task force (globalinvestorcoalition.org/see-gic-letter-tcfd/).
- 3) Narrative reporting which allows comparisons between successive disclosures and thereby demonstrates progress is essential. Methodologies should be comparable across years and should include comparable information about past capital allocation strategies to indicate a clear sense of the company's recent and forward-looking trajectory with respect to the energy transition.

We also suggest the task force recommend disclosure of the links between climate change and water risk. Water issues create material, physical, regulatory and reputational risks (and some opportunities) to companies and investors, from shareholders of companies in industries with large water use to owners of physical assets such as commodities, real estate, farmland and infrastructure to holders of debt or equity positions in government entities or corporations. Climate change and related droughts, floods and extreme weather exacerbate existing water supply and quality risks.

5. For users of climate risk and opportunity information, what are five specific points of information that you wish to secure?

Investors wish to secure:

- (1) Disclosure of 2 degrees stress testing methodologies, assumptions and results;
- (2) The financial consequences of current climate-related physical, regulatory, technological or indirect impacts and ranges of financial consequences of future impacts, wherever possible;
- (3) Company strategy for responding to and managing risks and opportunities, including disclosure of senior management and board policies, activities, and remuneration related to climate risk; disclosure on impact of scenarios on capex plans (see Q6 for an example); disclosure of public policy positions and lobbying activities;
- (4) Scope I, II and where relevant Scope III emissions, including material equity exposures; and
- (5) Targets and metrics for measuring progress against targets including GHG reduction, energy efficiency of operations and products and climate-related initiatives.

6. Are there any best-practice disclosures of climate risks by companies that you would like to bring to our attention? What specific climate elements of this disclosure would you like to highlight? (Please limit to two examples)

As a diversified mining company, BHP Billiton has disclosed the portfolio implications of a 2 degrees pathway, identifying risks and opportunities by type of commodity. The analysis quantified – based on different trajectories for carbon prices in key jurisdictions - the EBITDA implications of a range of scenarios, including an orderly transition as well as the possible consequences of a “hard landing”. Key merits of this report are:

- A range of climate scenarios are linked to financial performance, allowing investors to take their own view.
- Disclosure at a meaningful level for investors (in this case, by type of commodity).

However, BHP Billiton did not include important details such as the assumptions underlying the 2 degree scenarios that it tested against, which types of policies and technologies drove the 2 degree scenario, or whether specific types of projects within the commodity type (such as shale versus conventional gas or oil sands versus deepwater reserves) would be affected.

Unilever’s CDP response discloses the company’s response both in the short- and medium-term, the integration of climate risk into corporate strategy, and cost assessments for six climate risks/opportunities (such as fuel/energy taxes and regulations; changing consumer behavior).

7. “Transition Risk” in terms of climate is an evolving term. How would you define this risk? What specific disclosures would help measure it?

Transition risk may be defined as financial risks to companies, sectors and *economies* which result from the shift towards a lower carbon economy. This includes effects of changes in policy and technology, and market shifts such as decrease in demand for fossil fuels that can significantly affect the revenues and valuation of companies, especially in high carbon sectors. Assessment of transition risk should always include an analysis of the cost of not transitioning (similar to the “hard landing” scenario used in the ESRB report “Too sudden, too late”) as well as offsetting transition cost with gains in terms of the opportunities.

Corporate disclosures that help measure transition risk include 2 degrees stress testing information, strategies for transitioning to a lower carbon economy, the setting of science-based, absolute emissions reduction targets,

CAPEX and R&D plans, revenues allocated to cope with the physical impacts of climate change, and Scope I and II, and where relevant, Scope III emissions.

8. Which three sectors do you think most exposed to climate risks? For these sectors, how are physical, transition, and liability risks best measured and reported?

The energy, real estate and industrial sectors are among those most exposed.

Energy companies should disclose transition risk through 2 degree scenario analyses (see Q13). They should disclose how physical impacts can disrupt supply, alter demand patterns and damage infrastructure; how the company is assessing financial risks and opportunities associated with climate policies, technology advancement, and other environmental issues related to the energy transition with respect to existing and planned operations and assets; and how traditional valuation methods (i.e., reserves replacement ratios in oil and gas) can be changed to align with the energy transition. Utility companies should disclose by country (since they are heavily impacted by national and regional policy and energy markets) and by asset.

Real estate: *Sustainable Real Estate Investment: Implementing The Paris Climate Agreement*¹ and *Managing Investment Risks From Climate Change: Property And Construction Sector*² are good starting points. The real estate sector is most affected by the physical risks of climate change, but also has some of the greatest opportunities in terms of energy efficiency improvements.

Industrial companies should disclose 2 degree scenario analyses to address transition risk and potential impact on fuel and electricity costs. They should disclose in the geographic scope that is most relevant to their energy and carbon cost, in line with the regulatory framework most relevant to them.

9. How should the task force consider the challenge of aggregate versus sector-specific climate-related financial risks and opportunities?

Disclosure by companies should be part of mainstream financial filings and financial consequences should be quantified against a range of emissions scenarios (such as a well below 2 degrees scenario, a 2 degrees scenario and the Paris INDC scenario/2.7 degrees). Financial quantification of emissions scenarios would facilitate both sector-wide and economy-wide aggregation. We support aggregation for financial stability purposes and for guiding sector-specific investment decisions. Aggregation at the sector level will form the basis of economy-wide aggregation.

The task force should consider developing sector-specific guidelines for the most exposed industries. The guidelines should recommend the appropriate level of disclosure by each company (company portfolio-wide, asset-level), the right geographic scope (global, regional, national, subnational), the right scope of emissions (Scope I and II or also Scope III) and the right timescale (depending on company investment horizons) - in order to ensure comparability within sectors.

¹ Available at <http://www.unepfi.org/work-streams/property/sustainablereji/>.

² Available at http://www.igcc.org.au/Resources/Documents/Managing Risks Guide_Property and Construction.pdf.

10. Is there a role for scenario and sensitivity analysis—for the nonfinancial and/or financial sectors? Please provide three specific examples.

Non-financial sector

Both scenario and sensitivity analysis should be used to give a complete picture of the vulnerabilities of exposed companies. Sensitivity analysis – which would usually test the impact of one or several variables – can be useful in understanding the impact of specific events or outcomes. A good example might be the vulnerability of proven fossil fuel reserves to a reduction in demand, for example, or an increase in the carbon price and can thus be applied to the fossil fuel industry. Usage of shadow carbon prices in making CAPEX decisions is another example of using sensitivity analysis.

Scenario analysis involves a more complex analysis against a set of internally consistent variables. It will produce a set of probable outcomes that will be more useful in informing investment decisions because they will capture the complexity of climate change better. Scenario analysis has been successfully used by BHP Billiton in understanding the implications of several emissions paths on the commodity portfolio of the company.

Financial sector

Risk analysis in the financial sector will be even more complex, but will benefit from scenario analysis by companies.

ASSET-CLASS DIMENSION

11. Which are the key asset classes that require initial attention? Are there any gaps that we should focus on? Within this, what are the top two priorities for action?

All require initial attention:

- Equities
- Fixed Income
- Commodities
- Project and Infrastructure Finance
- Real Estate
- Private Equity
- Loans and other bank financing
- Other

Gaps to focus on:

- Fixed Income
- Private Equity
- Loans and other bank financing
- Real Estate

Top two priorities for action within the “gaps” category:

- Fixed Income
- Private Equity

INTERMEDIARY/USER SCOPE

12. Considering the breadth of services the capital supply chain provides, please provide up to three examples of leading work (research or other) from sell-side brokers’ investment recommendations, listing rules of stock exchanges, portfolio management and stewardship examples by fund managers, fund-manager recommendations by consultants, or others we should consider.

- The Mercer Report “Investing in a Time of Climate Change” analyses the implications of a range of emissions scenarios on different asset classes.
- The Smith School Sustainable Finance Programme’s recent report on thermal coal aggregates asset level (bottom-up) data across the coal value chain, selecting the correct geographical scope (depending on the type of industry, climate risk will materialize on a regional, national or global level).
- The Carbon Tracker Initiative has started from a top-down carbon budget to derive assets at risk of stranding in the fossil fuel industries, as well as outlining possible transition scenarios at industry and company levels.

13. Please identify three examples of existing disclosure practices on climate risk and opportunities that you consider to be effective by investment banks, stock exchanges, investment managers, investment consultants, or asset owners. Please indicate the preparer and type of disclosure.

A growing number of investors are disclosing their carbon footprint, which communicates current exposure but does not of itself give an indication of future risks and risk management strategies. Some pension funds, such as the UK Environment Agency Pension Fund, have disclosed a more in-depth analysis by asset class, against a range of emission scenarios. The UK Green Investment Bank annual report discloses performance against a double bottom line of green improvements and profitability, which is a leading example from a pure play green investment institution. Currently, 120 investors have disclosed their carbon footprint under the Montreal Pledge, which gives investors the appropriate level of flexibility given the nascent state of disclosure tools.

14. How can climate risk information be simply summarized for retail investors? What standards or mechanisms exist for assuring end investors that climate risks and opportunities have been considered in the way that their savings and investment and pension products have been managed?

n/a

MACRO SCOPE

15. In conducting macroeconomic analysis, what are the top three key measures of macroeconomic climate risk performance when seeking to measure the extent to which the global economy is transitioning towards net-zero emissions?

- Global emission levels in absolute numbers and emissions intensity of GDP – historical development and future projections (such as done in the IPCC reports)
- Total new investment into low-carbon technologies versus emissions intensive investment (such as through the IEA energy investment reports)
- Rate at which existing emission intensive assets are being replaced by low-carbon assets

For financial stability purposes, the total value at risk from the regulatory or technological obsolescence of emission intensive assets should be aggregated – this could be done based on IEA modelling. It should be tracked how this value evolves to understand the transmission of the policy signal into business and investment decisions and thus the cost-effectiveness of the low-carbon transition.

Analyses should cover both how efficiently the risks involved in the transition are mitigated and how comprehensively the global economy is utilizing the opportunities.

16. One way to measure transition risk is by considering disclosures based on sector/market scenario analysis. What scenario planning work is currently available in this area?

n/a

17. The United Nations Framework Convention on Climate Change five yearly “global stocktakes” seek to establish in part whether financial flows are consistent with the less-than-two-degree scenarios. Are there any climate-risk disclosure recommendations that would appropriately feed into such an effort?

Governments should communicate how they plan to transition their economies towards net zero emissions through national plans. All countries should, to the extent possible, quantify total investment needs for low-carbon technologies to enable investors to assess investment opportunities on a country-by-country basis.

UNFCCC stocktakes should be aligned to the policy objectives and trajectories in the Paris Agreement, including targets to limit warming to 2°C and move to net zero global emissions. Stocktakes should be aligned with macroeconomic climate risk measures, including emissions intensity of GDP (current and projected), total new investment into low-carbon technologies versus emissions intensive investment, the rate at which emission intensive assets are being replaced by low-carbon assets. Global investment in adaptation and current/projected adaptation costs should also be fed into stocktakes. Analyses should occur on a sector level.

18. How should the Task Force define success?

Increased convergence and standardisation in climate-related financial disclosure that is usable by investors, policy-makers, companies and the wider community.

The adoption rate of reporting recommendations at country, industry and company levels should be key measures of success.

Rate of application and use of the data by investors and other ‘users’. Increased demand for meaningful disclosure across the investment value-chain.

Level of support and endorsement by financial regulators across key jurisdictions.

Comprehensive consultation across a wide spread of jurisdictions and markets to ensure appropriate consideration of different reporting regimes and challenges.

Integration of climate-related financial disclosure and reporting into global, regional and national policy frameworks.

Increased understanding and awareness of the economic and financial implications of climate change and climate-related financial risks, and the financial system’s exposure to climate-related risks.

Enhanced shift from emissions intensive to low-carbon investments, and the development of products, such as low-carbon indices, green bonds and others.

Increased support for climate-related shareholder resolutions.

19. What are the key barriers that you believe the Task Force needs to overcome?

The primary barriers has already been identified: the tragedy of the horizons means that long-range climate risks from transition, physical impacts and liability are more difficult to assess and incorporate into financial regulation.

Industry has been reluctant to integrate climate disclosure into financial filings, preferring to use voluntary disclosure. Ensuring that the disclosure recommendations are financially material and fit for purpose in financial disclosures will be key. Focusing on governance and oversight to ensure Board-level sign-off is also critical.

Directors are traditionally reluctant to adopt forward looking disclosure, citing both materiality and uncertainty as key inhibitors.

Managing reporting timeframes is a factor, and the disconnect between traditional financial reporting timeframes and climate change impact timeframes, particularly in assessing materiality of climate-related financial disclosure.

Getting the balance right between comparability and materiality will be challenging within and across industry sectors.

Financial regulators need to be better engaged to understand the financial dimension of climate risk disclosure and their role in encouraging take-up of the recommendations.

20. Is the Task Force focused on the appropriate set of topics for its phase II workplan?

Yes, they are broadly appropriate.

The needs of users of climate-related disclosure, current gaps and future recommendations are interconnected. Given that the financial community are a key constituency in this discussion, it is vital that investors and financial intermediaries are closely involved in all aspects of this review. This will help to ensure that information disclosure is useful and therefore applied on an ongoing basis both in investment decision-making processes and across the investment value chain.

The Governance workstream will need to address considerations of how boards and trustees currently approach climate risk and questions of materiality of climate related financial risk in their processes as well as questions of fiduciary duty and legal obligations for disclosure. Particularly with regards to forward looking statements and qualitative disclosures.

Strategies for promoting adoption and ensuring a means of measuring and assessing ongoing progress will be key.

21. What additional topics should it consider?

Given that investors usually invest across both national and global economies, focus on the implications of climate-related financial risk for financial system stability could be enhanced. This will help regulatory

authorities to adopt a more consistent approach to reviewing and assessing macroeconomic implications and flow through requirements for corporate disclosure.

22. The Task Force plans to reach out to a broad sample of key stakeholders among preparers, users, and standard setters. Are there particular types of entities or organisations that you believe the task Force should reach out to?

Asset owners such as pension funds, insurers and endowments will be crucial drivers for the overall success of your work. Therefore, the TCFD should engage additional asset owner representatives, especially pension funds.

The TCFD should engage with government officials, securities regulators and central banks to ensure integration between current financial reporting practices and climate risk reporting. This will increase understanding of successes and obstacles governments face when seeking to improve disclosures, will educate officials on the need for improved reporting, and increase the likelihood that governments will put in place enabling policy frameworks to support the task force's objectives.

Non-listed entities should be consulted to promote better voluntary disclosure.

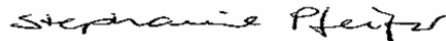
Consultation is undertaken with stakeholders across a wide range of geographies and jurisdictions to ensure that the recommendations are mindful of the different market and regulatory regimes in operation. This should build on best practice examples by investors.

Thank you very much for your consideration. In conjunction with our institutional investor partners, we look forward to providing our input and support throughout the year as the Task Force advances its critical mission.

Yours sincerely



Emma Herd
Chief Executive, Investor Group on Climate Change
(Australia/New Zealand)



Stephanie Pfeifer
Chief Executive, Institutional Investors Group on
Climate Change (Europe)



Chris Davis
Chief of Staff, Ceres Investor Network on Climate Risk
(United States)