ALLEN & OVERY

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# Climate Change reporting

## Task Force on Climate-related Financial Disclosures

At the end of last year, the Task Force on Climate-related Financial Disclosures (the **Task Force**) published its Recommendations Report on climate change related financial disclosures.

The 32-member Task Force was established by the Financial Stability Board (the **FSB**) to help identify the information needed by investors, lenders and insurance underwriters to appropriately assess and price climate-related risks and opportunities. It follows concerns over whether climate-related risks are being properly identified and priced and the impact this may have on financial stability. The Task Force was asked to develop voluntary principles on climate-related financial disclosures that would be useful to investors, lenders and insurance underwriters in understanding material risks.

The recommendations made by the Task Force would apply to all financial and non-financial organisations with public debt or equity. Other organisations are also encouraged to adopt the guidelines. It is proposed that the reporting of climate-related disclosures would be through an organisation's mainstream (ie public) financial filings.

The Recommendations Report is a further step in the shift towards greater transparency and reporting (both mandatory and voluntary) of environmental, climate and human rights issues which may affect businesses.

**Background**

The FSB considers that investors, lenders, and insurance underwriters need to understand how climate-related risks and opportunities are likely to impact an organisation's future cash flows and its assets and liabilities in order to make better informed financial decisions. It has concerns that inadequate information about risks can lead to a mispricing of assets and misallocation of capital and can potentially give rise to financial instability due to market corrections.

**Recommendations on climate-related financial disclosures**

The Recommendations Report outlines four recommendations on climate-related disclosures that are applicable to organisations across sectors and jurisdictions. Importantly, the Task Force's recommendations apply to financial sector organisations, including banks, insurance companies, asset managers and asset owners as well as non-financial service businesses. The proposals will also be directly relevant to large companies in sectors such as energy, transportation, real estate/construction, metals, mining, chemicals and packaging.

The Task Force structured its recommendations around four thematic areas that represent core elements of how organisations operate:

- governance;
- strategy;
- risk management; and
- metrics and targets.

Each thematic area is supported by three to four recommended disclosures which require an organisation to describe the steps it is taking in respect of a climate-related risk or the impact of a climate-related risk upon it. Guidance for each recommended disclosure (on an all-sectors and sector-specific basis) builds out the framework with the types of information the Task Force expects an organisation to disclose to assist investors and others in understanding how it assesses climate-related risks and opportunities. The recommended disclosures for the metrics and targets limb also require that organisations provide the metrics used to assess climate-related risks and, in particular, risks associated with water, energy, land use and waste management. The guidance also covers the disclosure of data on certain greenhouse gas emissions and related risks.

For the financial sector and certain non-financial sectors, supplemental guidance has been developed to highlight specific considerations for those sectors. Within the financial sector, specific guidance exists for banks, insurance companies, asset owners and asset managers. For the non-financial sector, supplemental guidance applies to the energy, transportation, materials and buildings, agriculture, food and forest products sectors.

The Task Force recommends that climate-related financial disclosures are included in an organisation's mainstream (ie public) financial filings.

**Scenario analysis**

One of the Task Force's key recommended disclosures is related to the disclosure of potential impacts of climate-related risks (and opportunities) on an organisation's businesses, strategies, and financial planning under different potential future scenarios, including a 2° Celsius scenario. The Task Force considers disclosure of how organisations analyse different climate-related scenarios, and the considerations associated within the individual scenarios, as a key step to better understanding the potential financial implications of climate change on a business.

Importantly, it is recommended that organisations undertake both historical and forward-looking analyses when considering the potential financial impacts of climate change, with greater need for forward-looking analyses as the efforts to mitigate and adapt to climate change are without historical precedent. This is one of the reasons the Task Force believes it is important for organisations to incorporate scenario analysis into their planning.

The Task Force recognises that, for many organisations, scenario analysis may be a highly qualitative exercise. However, organisations with more significant exposure to transitional and/or physical risk should undertake a more rigorous qualitative and, if relevant, quantitative, scenario analysis. Businesses with more significant exposure to climate-related issues should consider disclosing key inputs and assumptions related to their scenario analysis to allow users to understand the process and its limitations.

**Relationship with other reporting initiatives**

The Task Force recognised that a number of different reporting frameworks have emerged over the last few years and it is important to see the Task Force's recommendations within this broader context.

The Task Force considered existing voluntary and mandatory climate-related reporting frameworks in developing its recommendations and the Report comments on the alignment of existing frameworks, including those developed by the CDP (the former Carbon Disclosure Project), the Climate Disclosure Standards Board, the Global Reporting Initiative, the International Integrated Reporting Council, and the Sustainability Accounting Standards Board.

Whilst many frameworks are voluntary there are a number of mandatory regimes in place which relate to climate-related reporting. By way of example, in the UK, it has been mandatory since 2013 for qualifying companies under the UK Companies Act 2006 to keep their investors informed of certain environmental matters and GHG emissions through their strategic and directors' reports respectively. At an EU level, the Non-Financial Reporting Directive (2014/95) (the **NFRD**) builds upon existing reporting requirements across Europe.

**Next steps**

The Report represents a further evolution in the disclosure of environmental and climate-related impacts on businesses. For those organisations which may be affected, it is likely to become increasingly hard to ignore the guidance once adopted as investors (amongst others) look for a tangible way in which to price potential climate impacts. It is therefore important that you have your say. Comments can be submitted to the Task Force on the draft Recommendations Report up until 12 February 2017. It is expected that the Task Force will issue an updated report to the FSB in June 2017.

# Key contacts

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