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Latest Developments from the Task Force on Climate-related Financial Disclosures

1. Background

The Task Force on Climate-related Financial Disclosures or TCFD, was established by the Financial Stability Board to "improve and increase reporting of climate-related financial information." They argue that, without this type of information, financial institutions cannot accurately include climate-related financial risk, which is growing in importance and value. In addition, the availability of transparent information will allow informed decision making and should aid in accelerating the energy transition and adaptation measures. The recommendations focus on both positive (opportunities) and negative risks as well as transition risks.

The first report was published in 2017 and comprised a set of recommendations on how to disclose climate-related financial considerations in four interlinked major areas. These were governance, strategy, risk management, and metrics and targets.

One of the long-term objectives is to have only quantifiable metrics reported with each evolution of the TCFD recommendations and associated metrics moving the disclosures closer to that end goal. An annexure to the report entitled "Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures" to give guidance on implementation and a technical report on "The Use of Scenario Analysis in Disclosure of Climate-Related Risks and Opportunities" were also published in 2017. The strength of the recommendations is that they include future looking processes such as strategy and risk rather than only reporting on current performance. They are unique in recommending the use of climate change scenarios and making the explicit link back to strategy and risk and future looking metrics and targets and how to transition towards the end goal and, therefore, set themselves apart in this regard.

Governance
Disclose the company's governance around climate-related risks and opportunities

Strategy
Disclose the actual and potential impacts of climate-related risks and opportunities on the company's businesses, strategy, and financial planning where such information is material

Risk Management
Disclose how the company identifies, assesses, and manages climate-related risks

Metrics and Targets
Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material

2. 2021 Status Report

Since 2017, the focus has been on assisting with the implementation of the recommendations. Sector specific guidance has been developed as well as status reports that track uptake. Including sector specific guidelines has ensured that uptake amongst non-financial organisations increases. The focus has been on sectors that are likely to be most impacted by climate change considerations.

In mid-October 2021, the latest Status Report was published which assesses uptake, together with two additional documents both of which are updates of the:

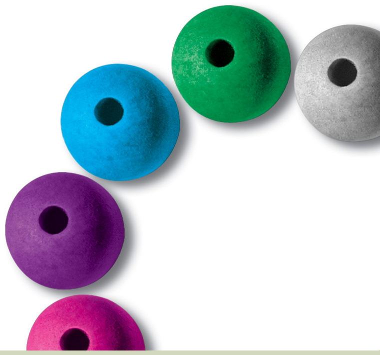
- Implementing the Recommendations of the TCFD report.
- Guidance to assist companies with disclosure of climate-related metrics, targets and transition plans.

The Status Report tracks TCFD recommendation aligned disclosure across both financial and non-financial sectors as detailed below:

- The document highlights that the rate of uptake has grown 9% over the 2019-2020 period. This is more than double the rate in 2018-2019.
- The recommendations now have approximately 2 600 global supporters from 89 countries, of which 1 069 are financial institutions, with assets of $194 trillion. The report acknowledges that there is still a long way to go before all relevant organisations are using the recommendations as only one in three companies reviewed disclosed according to TCFD recommendations.
- New requirements, aligned with TCFD recommendations for reporting, were put in place by various entities, including governments who are embedding them into policy and regulation. This includes the European Union where the greatest number of supporters are located.

In the Implementing Recommendations document, it makes recommendations to assist reporting organisations with the following:

50%
of the companies that were included in the status review had disclosed their climate-related risks and opportunities.



Directions on the application of the recommendations, including materiality assessments and location of disclosures

Information on assessing financial impacts of climate-related risks and opportunities (collectively referred to as climate-related issues)

Recommendations and supporting recommended disclosures that describe information needed by investors, lenders, and insurance underwriters to make economic decisions

Guidance that provides context and suggestions for implementing the recommendations

Supplemental guidance that highlights important considerations for the financial sector and non-financial industries potentially most affected by climate change

Seven principles for effective disclosure developed by the Task Force to help guide current and future developments in climate-related financial reporting

Major changes made in the 2021 document are:

In the strategy section it is recommended that:

- Banks include exposure from carbon-related assets from non-financial groups identified in the 2017 report.
- All sectors address disclosure of actual financial impacts on organisations together with plans for transitioning to a low-carbon economy (transition plans).
- When using climate scenarios, to address disclosure of potential financial impacts on organisations more explicitly.

In the metrics and targets section there are various changes, but significant ones include:

- Seven new categories of metrics were identified that can be applied across various sectors. The new guidance thus aids in normalising performance and impact across different sectors.
- Additional disclosure for banks, insurance companies, asset owners and asset managers regarding the extent to which their activities and assets are aligned with a scenario well below 2°C.
- Revised disclosure of Scope 1 and Scope 2 greenhouse gas emissions independent of a materiality assessment and encouraged disclosure of Scope 3 GHG emissions.
- Additional disclosure of cross-industry, climate-related metric categories targets and interim not just medium and long-term targets, where applicable.

In the **Guidance Document**, feedback, developments, and issues are addressed to provide guidance for users of the recommendations in preparing and analysing the climate-related information being disclosed. The guidance includes which organisations should use the report, which metrics to choose, how to set climate-related targets, how to develop transition plans and how scenarios can assist in this regard. Importantly, the document also gives critical guidance in translating this information into financial performance impact.

TCFD facilitated several feedback sessions with users to discover where further guidance was required as well as including guidance for the new recommendations as highlighted in the above section. They note the various developments in climate related reporting around the world and the fact that more and more convergence is being realised.

3. Alignment with other reporting frameworks

The TCFD process, although unique in some ways, forms part of a plethora of ESG related reporting standards. The Better Alignment Project, started in 2018, is an attempt to align the various frameworks and avoid users having to use different reporting standards and frameworks, which is neither productive nor efficient. It is driven by the Carbon Disclosure Project (CDP); the Climate Disclosure Standards Board (CDSB); the Global Reporting Initiative (GRI); the International Integrated Reporting Council (IIRC); and the Sustainability Accounting Standards Board (SASB).

The Better Alignment Project has analysed the alignment of these reporting frameworks against the TCFD. In 2019, they found that there were no areas of conflict, high levels of alignment and 80% of the TCFD's metrics were covered by CDP, GRI and SASB.

The work of the Better Alignment Project continued to further align the metrics, but it is noteworthy that the TCFD documents have removed the alignment tables that were previously included, citing that a high degree of alignment has been achieved.

4. Implications for South Africa

ESG investing and reporting is gaining in momentum and importance. The TCFD forms an important cog in this wheel given the importance of financial considerations in the climate change and energy transition debates. The question is, what will be the impact on South Africa, given its fossil-fuel-intensive economy.

The TCFD has been considered by many organisations in South Africa, including National Treasury, in their 2020 report on Financing a Sustainable Economy, where it is recommended that *"Regulators and industry to co-develop or adopt technical guidance, standards and norms for use across all financial sectors in identifying, monitoring and reporting and mitigating their environmental and social (E&S) risks, including climate-related risks, at portfolio and transaction level. These should include E&S risk management frameworks, the use of science-based methodologies, and the incorporation of the recommendations of the TCFD."* A survey was carried out and it was reported that *"only 37% of respondents already report on information relevant to climate change impacts."*

National Treasury, together with various partners, is working on the recommendations that were identified in the Financing a Sustainable Economy Report including developing a *"benchmark climate risk scenario for use in stress tests by the financial sector"*. This speaks directly to the TCFD recommendations around addressing not only immediate, but also longer-term climate related risks, using scenarios as a tool.

The Worldwide Fund for Nature in South Africa did a survey on uptake and issues in South Africa and included the financial sector. This included asset managers and owners, investors, companies, and broader civil society players. The report was published in 2021 and it was found that awareness is relatively high in the financial and other sectors, but that uptake is still slow, but higher in the investment industry. Their analysis also showed that awareness and uptake are increasing, and many organisations are taking a phased approach, starting with some of the recommendations (mostly strategy and governance) and then growing over time and reporting on the targets and metrics.

The trend towards aligning and combining the broader ESG and sustainability reporting frameworks needs to continue. Small and medium sized companies are already struggling with the reporting burden and as much as possible needs to be done to grow these companies to boost economic growth.

It is clear that the TCFD is growing in complexity, uptake and importance globally and thus should be on the agenda of financial sector players. Given that South Africa is very vulnerable from a trade perspective due to the high carbon footprint of many manufactured goods, it is critical that awareness and uptake are increased. The increase in consideration of carbon border tax adjustments, particularly from the EU, should accelerate action in this regard. It is, however, critical that the socio-economic implications of the energy transition and investment patterns are carefully considered in addition to the financial risks.

Overall, the TCFD is a necessary initiative to help guide companies towards a more sustainable path, but it cannot be just a tick-box exercise if it is to have a significant benefit. Using the framework to truly analyse strategy and then translate that into long term, measurable shifts will ensure that the full benefits materialise. South Africa is still a developing country, and the transition must be just. The fact that the TCFD framework encourages future thinking and scenario analysis therefore makes it a good tool, if used correctly.

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