ESGCLARITY

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Four TCFD considerations for asset managers

By Curtis Ravenel, member, TCFD Secretariat

TCFD Secretariat member Curtis Ravenel says targets and progress against climate-related metrics are now expected

After years of stalled progress in addressing climate change, it's hard to miss the surge of energy and attention global policymakers are devoting to climate issues this year. The new US administration has put climate front and centre in its policy agenda, promising a "whole-of- government" approach, and countries all over the world are including sustainability in their plans for a "green recovery" from Covid-19's economic devastation.

It's not a moment too soon. The climate crisis is accelerating, bringing the effects of climate change into more and more aspects of our lives. And just as climate change is increasingly threatening our health and communities, it also poses increasing risks to financial stability, the global economy, and our investments.

Capital markets are taking notice. Policymakers and investors understand we can't protect our financial system against the risks of climate change unless we can measure, compare, and inform the markets of those risks. The markets need high-quality, decision-useful information from companies to make smart capital allocation decisions.

And there is good reason to view climate change as a financial risk. According to research by S&P Global, 60% of companies on the S&P500 hold assets that are at high risk of at least one type of physical climate-related risk. Moody's cited ESG risks as material credit considerations in 33% of the private sector rating actions published in 2019 and said climate risks are "taking on greater prominence in discussions of credit quality".

TCFD recommendations

We are seeing this first-hand at the Task Force on Climate-Related Financial Disclosures (TCFD). The G20 Financial Stability Board established the private sector-led TCFD in 2015 and in 2017, the TCFD published voluntary recommendations, developed by the market, for the market, to help companies disclose more effective climate-related financial information through existing reporting channels. In developing its recommendations, the Task Force drew from existing climate-related reporting frameworks (including CDP, CDSB, GRI, IIRC, and SASB) and created recommendations that rest on the four pillars of governance, strategy, risk management, and targets and metrics. There are 11 specific TCFD recommended disclosures.

Today, almost 1,900 global organisations support the TCFD, including financial institutions responsible for assets of nearly $160trn. These include the largest asset owners and asset managers in the world, such as GPIF, Norges Bank, Axa, BlackRock, State Street, and UBS Group, among others. In 2019, more than 40%

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of companies with a market capitalisation greater than $10bn disclosed in line with TCFD recommendations, and based on the increasing interest, we expect these numbers to continue to grow.

Organisations in nearly 80 countries have endorsed the TCFD recommendations, and some have gone further. New Zealand, Hong Kong, the UK, and most recently, Switzerland, are taking steps to make TCFD-aligned disclosures mandatory and the European Commission is expected to table legislative proposals to this effect shortly.

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With additional jurisdictions signalling mandatory requirements in this area, now is the time for asset managers to prepare for climate-related financial disclosure. The TCFD recommendations provide in-depth guidance for asset managers to disclose climate-related information, but we recommend four steps to start preparing your institutions for change:

- **Ensure your board members are engaged on climate-related issues.** A formal structure should put responsibility and accountability for climate issues in the boards' hands.
- **Integrate climate-related risk analysis into your overall risk analysis.** Enterprise risk management systems are well developed in financial institutions. Climate change should be included alongside other financial risk issues and handled in the same manner.
- **Educate business units, portfolio managers, brand management, and others across your business about climate-related risk and how it affects financial performance.** ESG teams should not be the only group in your business who understand climate-related risks and opportunities.
- **Understand climate-related metrics and targets – and work to improve them.** The TCFD provides illustrative metrics as part of the recommendations and is conducting a consultation regarding the development of forward-looking metrics. Targets and progress against these metrics are now expected.

Regardless of whether climate-related financial disclosure becomes mandatory, a growing body of academic evidence shows that accounting for the effects of climate change enhances risk-adjusted returns. And companies and financial institutions that implement TCFD recommendations report positive benefits in their governance structures, business resilience, and preparedness for regulatory change.

The financial, investor, and business communities must work to build considerations of climate issues into their financial decision-making, both to protect against risk and to identify the opportunities an economy in transition will create. Increasing the flow of capital to assets and investments that are best positioned to mitigate the worst effects of climate change is essential to building global resilience on a systemic scale, while delivering value to your clients.

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