Marsh

Reporting climate change risk

Preparing for compulsory disclosure

March 2022

The push for an international agreement on reporting climate change risk according to the Task Force on Climate-related Financial Disclosures (TCFD) recommendations is gaining momentum, with the United Nations, International Financial Reporting Standards Foundation, and G20 calling for adoption of the framework.

TCFD compliance is a significant undertaking for many companies, but the process presents the opportunity to improve climate change risk pricing and risk management generally, gain wider access to capital, and better meet investors' demands.

Organizations that do not take action regarding the TCFD recommendations risk having their exposure to climate change estimated by another party, likely to their detriment, while those adopting a proactive approach will undoubtedly reap benefits.

What is the TCFD?

There are numerous standards and frameworks for sustainability reporting, but the Financial Stability Board — which promotes financial stability worldwide — has chosen the TCFD as its vehicle for developing a globally accepted framework.

The TCFD was established in 2015 to promote more targeted and standardized climate-related reporting for use by companies, banks, and investors in providing information to stakeholders. The intention is that increased awareness of the financial implications of climate change will lead to more sustainable business models and solutions.

As Michael Bloomberg, who chairs the TCFD, said: "The risk climate change poses to businesses and financial markets is real and already present. It is more important than ever that businesses lead in understanding and responding to these risks — and seizing the opportunities — to build a stronger, more resilient, and sustainable global economy."

The TCFD advocates making 11 recommended disclosures around four core elements of climate-related risks:

- Governance: Disclose an organization's governance relating to climate-related opportunities and risks.
- Strategy: Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material.
- Risk management: Disclose how the organization 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.

One of the task force's key disclosure centers on the resilience of an organization's strategy, when different climate-related scenarios are taken into account. This includes a 2°C or lower scenario, where energy use and emissions are consistent with limiting the global average temperature increase to 2°C above the pre-industrial average.

Which countries have backed the TCFD?

Countries and regulators globally support the idea of making the TCFD recommendations compulsory. So far, 13 countries have endorsed the TCFD framework or similar and nine are in the process of making it mandatory (see figure A). Additionally, the International Financial Reporting Standards Foundation is establishing the International Sustainability Standards Board (ISSB) which will be aligned with the TCFD. This board could significantly widen implementation of the recommendations.

The global shift to compulsory climate reporting

The framework known as the Taskforce on Climate-related Financial Disclosure, or TCFD, is shifting from a voluntary approach to being the main regulatory response to climate risk.

European Union
Has not officially adopted the TCFD framework but is implementing the Sustainable Financial Disclosure Regulation, which has a broader reach than the climate-focused TCFD.

G-7: US, UK, Canada, France, Germany, Italy, Japan
In June 2021, the G-7 backed the idea of compulsory TCFD reporting.

NORTH AMERICA

Canada
Tied pandemic bailout funding to TCFD-aligned disclosures. The Bank of Canada has said it is "working towards aligning its future disclosures" with the guidelines.

The SEC has proposed rule amendments that would require domestic and foreign registrants to disclose climate information broadly in line with the TCFD and the Greenhouse Gas Protocol.

LATIN AMERICA

Brazil
The central bank plans to require banks to disclose in line with the TCFD.

Mexico
Banco de México recommends development of a regulatory/supervisory strategy following TCFD recommendations.

ASIA PACIFIC

Japan
Revised its corporate governance code in June 2021 noting that listed companies must disclose climate-related financial risks to their business in line with the TCFD recommendations.

New Zealand
In September 2020, became the first country to announce the implementation of mandatory TCFD reporting. Financial entities are likely to be required to make disclosures in 2023, at the earliest.

Singapore
The stock exchange regulator — Singapore Exchange Regulation — will require mandatory, TCFD-aligned disclosure starting in 2022 for issuers. In 2023, it will become mandatory for companies in key industries like finance and transportation, and in most industries in 2024.

Hong Kong
The Securities and Future Commission announced in December 2020 that by 2025, financial institutions and listed companies must disclose the financial impacts of climate change to their businesses in line with the TCFD framework.

EUROPE, THE MIDDLE EAST, AND ASIA

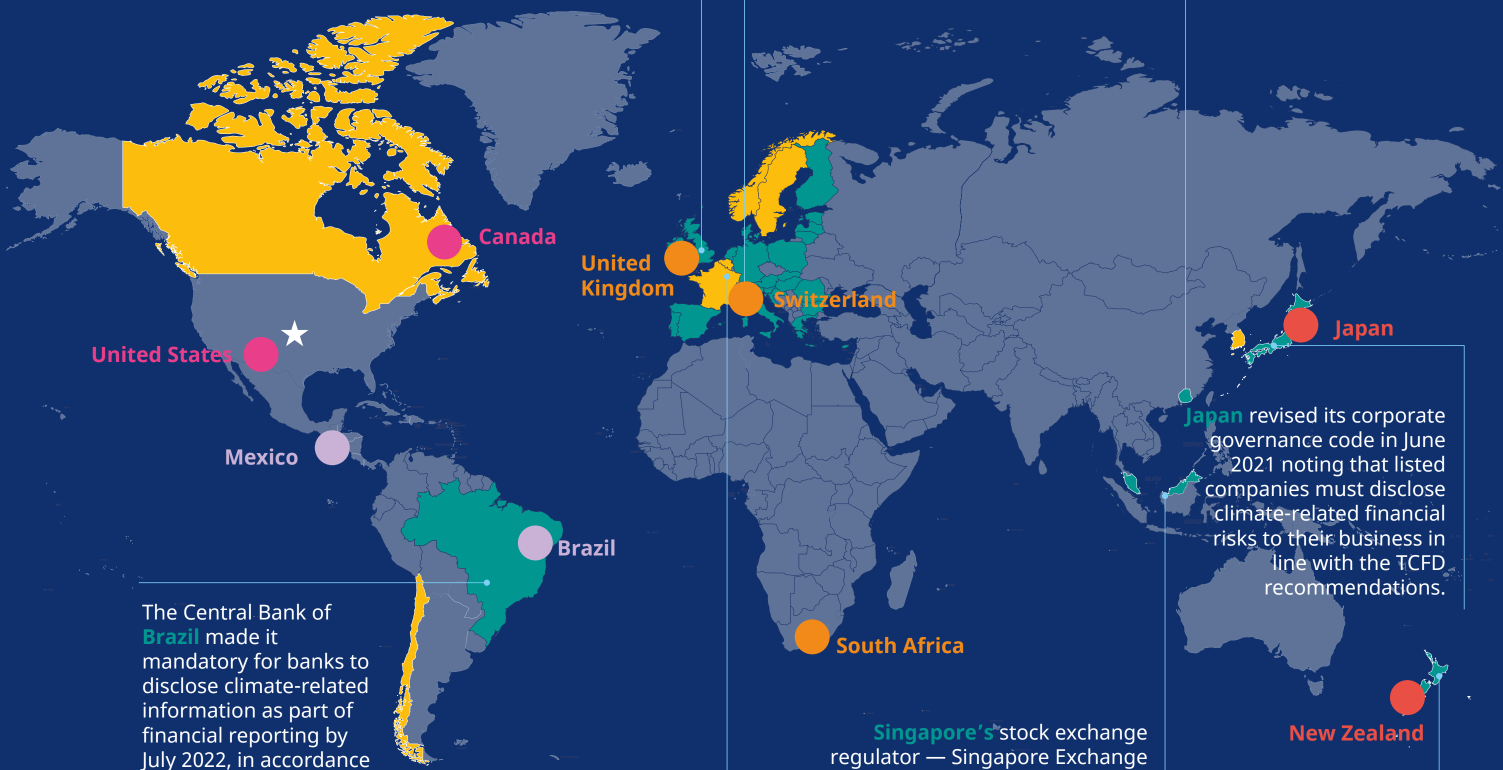
South Africa
The national treasury has recommended standards on environmental and social risks incorporating TCFD recommendations.

Switzerland
Has said it will enshrine TCFD reporting into law making it "binding".

United Kingdom
Has said it will make TCFD-aligned disclosures mandatory across the economy by 2025, with many of the requirements in place by 2023.

As of March 21, 2022.
Map includes select countries that are moving to make climate reporting under the TCFD framework mandatory rather than voluntary.
Sources: Allen & Overy; S&P Global Sustainable1; TCFD.

Figure: A


The UK intends to make the TCFD recommendations mandatory by 2025.
Switzerland is going to make the TCFD recommendations binding. The finance ministry plans a bill on mandatory reporting by mid-2022. Binding implementation of the TCFD framework is anticipated from 2024 for reporting on the 2023 financial year.
Hong Kong's Securities and Future Commission announced in December 2020 that by 2025, financial institutions and listed companies must disclose the financial impacts of climate change to their businesses in line with the TCFD framework.
Canada
United Kingdom
Switzerland
United States
Japan
Mexico
Brazil
South Africa
New Zealand
Japan revised its corporate governance code in June 2021 noting that listed companies must disclose climate-related financial risks to their business in line with the TCFD recommendations.
The Central Bank of Brazil made it mandatory for banks to disclose climate-related information as part of financial reporting by July 2022, in accordance with the TCFD recommendations. This was announced after a public consultation in April 2021 to set rules for disclosure of social, environmental, and climate-related risks by institutions of the National Financial System (SFN).
Singapore's stock exchange regulator — Singapore Exchange Regulation — will require mandatory, TCFD-aligned disclosure starting in 2022 for issuers. In 2023, it will become mandatory for companies in key industries like finance and transportation, and in most industries in 2024.
The EU's Sustainable Finance Disclosure Regulation (now known as the CSRD) integrating the TCFD framework came into effect in March 2021.
New Zealand in September 2020 became the first country to announce the implementation of mandatory TCFD reporting. Financial entities are likely to be required to make disclosures in 2023, at the earliest.
Countries and jurisdictions which have made the TCFD framework mandatory
Governments that have declared their support for the TCFD
US Treasury Secretary Janet Yellen has endorsed the framework, but the US has not made a formal statement of support

WHERE WILL REPORTING BEGIN FIRST?

The next five years will see many countries adopt mandatory reporting requirements, beginning with key sectors. Further rollout beyond key sectors and to medium-size countries can be expected later.

In addition, international bodies — including the United Nations, International Financial Reporting Standards Foundation, and G20 — are pushing for TCFD across the financial system. It is therefore only a matter of time before the TCFD framework will become a mandatory requirement.

2021

European Union

Standards under development by European Financial Reporting Advisory Group.

Disclosure requirements may apply beginning 2024.

2022

United Kingdom

Disclosure by over 1,300 of the largest UK-registered companies and financial institutions will be required from April 2022. Most UK organizations will see the reporting requirement come into effect in 2023.

2023

New Zealand

Disclosure by in-scope organizations will be required beginning 2023.

2024

United States

Disclosure by in-scope domestic and foreign registrants beginning 2024 for fiscal year 2023.

Switzerland

Large Swiss companies will be expected to report in 2024 for 2023 reporting period.

2025

Hong Kong

Disclosures will be mandatory across relevant sectors of the economy by 2025.

Source: TCFD

Impact for companies and organizations

Organizations across all sectors will ultimately be affected. However, the largest organizations and those with the most material climate risk are being targeted first. A company is likely to be impacted via two main channels:

Mandatory disclosures

The TCFD recommendations may become mandatory for certain companies. The TCFD has so far highlighted the following sectors as key: agriculture, food and forest products; energy; materials and buildings; transportation; and financial. Countries are adopting rollout strategies targeting these sectors first.

Voluntary disclosures

Action on the TCFD recommendations may follow after a company has voluntarily backed the initiative. Nearly 60% of the world's 100 largest public companies support the TCFD, among more than 2,700 supporters worldwide.

Companies have declared support for a number of reasons, including pressure from investors, lenders, underwriters, and supply chain partners and also to increase their understanding of climate risks and opportunities within their business.

Benefits of climate-related risk reporting

Physical, transition, and liability risks are increasing as a result of climate change.

The Financial Stability Board (FSB) reported that global economic losses resulting from weather-related catastrophes rose from US$214 billion in the 1980s (in 2019 prices) to $1.62 trillion in the 2010s, approximately trebling as a share of global GDP.

Public and private financial markets are already taking climate risks into account and pricing them accordingly, and alignment with the TCFD recommendations will enable them to do this further. Benefits to be gained from the process, especially if an organization goes beyond simply compliance, include:

- Improvement of enterprise risk management (ERM) following integration of climate risks.
- More informed strategy planning and scenario analysis.
- Increased access to capital and better terms.
- Progress on operational resilience.
- Improved ability to meet existing disclosure requirements by reporting material information in financial filings.
- Competence to address investors' demands for climate-related information, and in the format they request.

KEY ACTIONS TO TAKE

1. It is crucial for a company to understand its "go live" date, if there is one, and start preparing for that deadline early. Ideally, a company would be reporting according to TCFD recommendations for several years before the disclosures become compulsory.

2. Engage stakeholders, such as lenders, banks, and insurers, and ask what information they would like to see.

3. Analyze physical and transitional risks. Building a picture of a company's climate-related risks is perhaps the most difficult component of the TCFD recommendations. It is advisable to tackle the harder aspects of this exercise early on. Marsh's expertise in helping clients navigate catastrophic events makes us the de-facto leader in physical climate risk quantification.

4. Understand the four themes of the TCFD and its 11 recommended disclosures, as outlined below.

How to fulfil the TCFD's 11 recommended disclosures

Governance

Establish a risk management framework, as well as corporate risk and sustainability risk policies and procedures. Benchmark corporate practices against environmental, social, and governance (ESG)- related guidance.

Strategy

Map both physical risks resulting from climate change and the risks associated from transitioning to a reduced carbon economy. Benchmark likely outcomes with those of competitors.

Risk management

Quantify the financial impact of climate-related risks by sector and by geography, and analyze supply chain risk. Create resiliency through emergency response planning for physical risks and consider risk transfer options.

Metrics and targets

Establish relevant metrics for risk evaluation. These metrics could include revenues, expenditures, impact of climate change risk on assets, and capital financing. Undertake carbon footprint modeling.

Marsh's key services include physical and transition risk modeling, embedding of climate risk in enterprise risk management (ERM) frameworks and assistance in articulating climate risk analysis, ambition and resilience strategies for reporting requirements, including TCFD.

If you have questions on the TCFD recommendations, please contact your Marsh advisor.

About Marsh

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