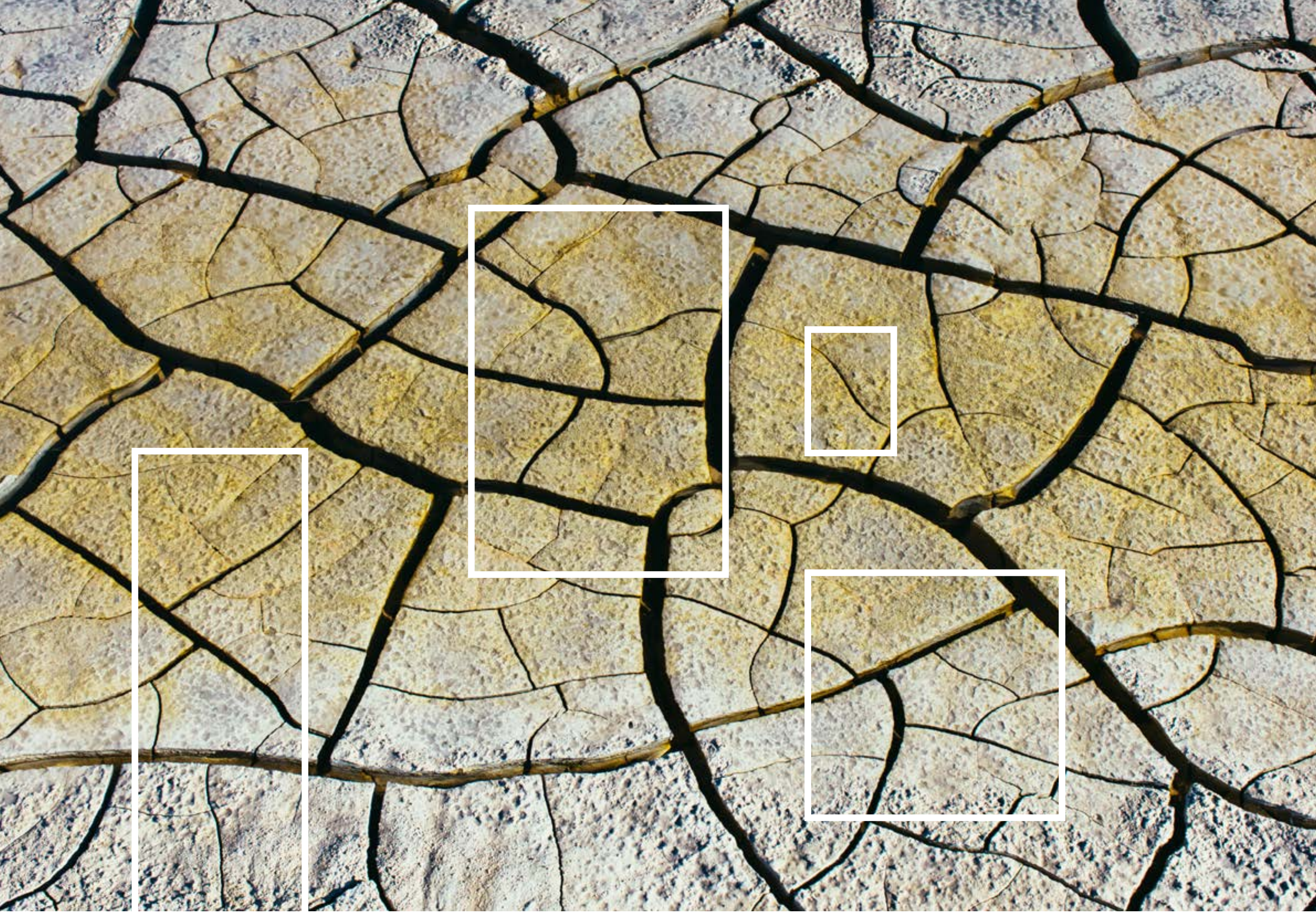
TCFD: a catalyst for corporate action on climate risk and resilience

By Torolf Hamm



TCFD has encouraged change at the core of corporate strategy globally. In this article we explore these changes and how TCFD requirements can give an organisation a head-start.

Getting to grips with Task Force on Climate-related Financial Disclosures (TCFD) requirements now can give companies a real leg-up in managing longer-term climate risks, while putting risk managers front and centre in an evolving hub of corporate strategy.

Recent years have seen a rising tide of structural and system-wide changes in the integration of climate considerations in private and public sector financial risk management.

When you have, for example, over 60 central banks around the world collaborating to share best practice and drive development of climate risk management[1], or you have large global organisations saying that sustainability will be central to their future strategy and choices, it's clear that a fundamental reshaping of the role of climate in corporate risk and finance is taking place.

On the basis that what gets measured, gets managed, an emerging force in that reshaping at the corporate level is TCFD. The group was formed in 2015 under the wing of the Financial Stability Board, with the high-profile advocacy of former Bank of England Governor, Mark Carney, and U.S. entrepreneur and former New York City Mayor, Michael Bloomberg[2]. TCFD provides a framework for companies to demonstrate to their stakeholders how they will be impacted by climate change, and their response to managing climate-related financial risks. Five years on, and well over 1000 companies around the world with a market capitalisation of many trillions of dollars have signed up voluntarily to the initiative[3]. However, the voluntary part may be short lived.

Support for TCFD to become a mandatory part of financial reporting in many parts of the world is growing. For example the UK's commitment to mainstream climate disclosure by 2022[4], and also the related consultation by the Financial Conduct Authority on whether all UK Premium listed companies should report on climate risk on a comply or explain basis.[5]

[1] https://www.politico.com/news/agenda/2020/07/14/federal-reserve-climate-change-341820
[2] https://www.fsb-tcfd.org/about/
[3] https://www.fsb-tcfd.org/tcfd-supporters/
[4] https://www.cdsb.net/mandatory-reporting/937/uk-expects-all-listed-companies-and-large-asset-owners-disclose-line-tcfd
[5] https://www.fca.org.uk/publication/feedback/fs19-6.pdf

What is involved?

Of course, many UK companies have been producing corporate social responsibility or specific sustainability reports for many years. But TCFD goes way beyond this sort of reporting and makes climate risks and resilience integral to financial reporting and projections. In short it recognises climate as a financial risk that should be assessed, quantified and managed.

The reporting framework covers four core areas for organisations to demonstrate how they are responding to the financial risks and opportunities that climate change presents[6]:

01
Governance
Governance around climate risks and opportunities

02
Strategy
The actual and potential impacts of climate-related risks and opportunities on strategy and financial planning.

03
Risk Management
How the organisation identifies, assesses and manages climate-related risks.

04
Metrics and targets
The metrics and targets used to assess and manage climate-related risks and opportunities.

A stepping stone

What TCFD certainly is not is just a financial compliance exercise. While TCFD will add financial teeth to the urgency for corporate action on climate risks and resilience, essentially its requirements come down to risk identification, management and mitigation.

Indeed, TCFD is effectively an opportunity to really get a handle on climate risks and their links to operational management, business performance and reputation. This is clearly the domain of risk managers – who can therefore have an important role in helping to develop a strategic response, potentially using the TCFD framework as a reference point.

Since the risks associated with climate risk and resilience vary from physical risks, and the related economic impacts to liability risks and financial risks arising from the pace of transition to a low carbon economy, it's important to address all of these. Broadly, they comprise:

- **Physical** – physical risks to premises, disruption of infrastructure and supply chains that arise from extreme and adverse weather and the economic losses that result.
- **Liability** – legal costs and damages that result from failing to meet responsibilities for climate risks.
- **Transition** – the legal, technology, market and reputation costs linked to how organisations adapt to, and the speed at which they adapt to, lower carbon and climate resilient economies.

In many ways, these risks are not new per se to risk managers; they translate into existing categories of financial risk such as credit, market, business, operation and legal risks. In particular, the transition to a net zero and resilient economy represents for many commercial sectors - such as real estate, retail and energy - a significant opportunity to strengthen a firm's brand or reputation and be recognised by investors as a climate sustainable investment. But equally, they do present new challenges, not least a more extensive modelling of the natural world and the need to develop a much more granular understanding of the transition to a net zero future.

As part of taking responsibility for, and playing an active role, in the transition to a low carbon economy, an essential step for most organisations will be to quantify how they will be affected by, and can affect, the climate change trajectory through mitigation measures and by building climate adequate and resilient solutions. Risk modelling and scenario analyses are at the heart of building this enhanced understanding. From this informed base, organisations can then start to assess the risk/reward and return on investment of different potential courses of action, the climate-related metrics that are most beneficial to the business and stakeholders, and the governance implications of different strategies.

[6] https://www.cdsb.net/sites/default/files/sasb_cdsb-tcfd-implementation-guide-a4-size-cdsb.pdf

Incentives for action

By being proactive on TCFD, organisations and risk managers can be far better prepared to understand evolving issues that are playing an increasingly important role in influencing corporate strategy and meeting stakeholder expectations for a just and orderly transition to a low carbon, climate resilient economy.

That's irrespective of whether TCFD is mandatory or not. Inevitably, some boards may question the need to comply with what is, for now, a voluntary directive, but that situation doesn't look like it will last for long in the UK. Bear in mind also that the purpose of the TCFD framework is not necessarily only to assess risk, but also to identify opportunities for companies to perhaps enter new markets or manage aspects of the business more efficiently.

Other tangible benefits of being in the early wave of TCFD adopters are the opportunity to be part of a broader movement that's increasingly meaningful to employees. Similarly, it's a real opportunity to solidify corporate reputation in an area that is under increasingly intense scrutiny across the stakeholder spectrum – no more so than in sections of the investment community that control vast amounts of capital, where environmental, social and governance (ESG) issues are fast becoming pivotal factors in investment decisions.

With the term 'greenwashing' already carrying real[7] and sometimes immediate reputational and financial impact, TCFD implementation is fast assuming the status of a reassuring statement of intent on managing climate risk and resilience.

Risk managers are uniquely placed to ensure their companies are prepared to meet the increasing expectations of disclosure by investors and regulators, embed climate risk into existing risk management frameworks and assist boards to take a strategic approach.

The arguments for doing so sooner rather than later, given the established direction of travel on TCFD, are mounting.

Further guidance and resources

How ready are you to issue your first TCFD report? Find out more

Climate risk and resilience. Read more

Our Climate Quantified solution. Find out more

[7] https://www.businessnewsdaily.com/10946-greenwashing.html

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