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Re: Comments on the Recommendations of the Task Force on Climate-related Financial Disclosures, and the Annex: Implementing the Recommendations of the TCFD, and the Technical Supplement - The Use of Scenario Analysis in Disclosure of Climate-Related Risks and Opportunities

Introduction

The Global Financial Markets Association ("GFMA") and the Institute of International Finance ("IIF") (together, the "Associations") are pleased to provide feedback to the Task Force on Climate-related Financial Disclosures (the "Task Force") on the draft Recommendations set out in the report published December 14, 2016.

The Associations are supportive of the aims of the Task Force and are pleased to present below their comments on the draft Recommendations. The comments are intended to be constructive and we hope they will help to improve the effectiveness of the Recommendations.

We have noted a number of possible areas for further work, and the Associations would be interested in exploring with the Task Force as to how they can best contribute to such work. Expanded industry-Task Force engagement from now on will be important to ensure that issuers and users are fully comfortable with the recommendations, and will be important to assure uptake of the recommendations.

Executive Summary and General Comments

The Associations understand and support the objective of greater public disclosure of financial risks arising from climate change and policy responses thereto, where material and relevant to the business of a given issuer. Such disclosures should, as intended, inform investors as to climate-related financial exposures to assist their investment and lending decision-making.

Although the report acknowledges materiality as a consideration for disclosures at several points, it needs to be made clear that climate and related financial disclosures necessarily need to be made subject to established principles of materiality analysis. Disclosure should be made where material, but firms must continue to have the right to make judgments about what is material to their investors and creditors, to avoid information overload or excessive disclosures that would rapidly become rote and of no value to users. This is essential to achieve appropriate balance and efficiency to support the intended use of the disclosures. As discussed below, it could be helpful for the industry to work with other stakeholders to develop guidance that would help firms make reasonably consistent determinations of whether climate-related risks are material financially to their businesses.

The report contains useful discussion of scenario analysis, but the Associations propose that the Task Force consider a two-step approach to the application of such analysis, as follows: First step: determining whether a climate-related issue is material financially to an issuer, given its business model, balance sheet, and exposures. If disclosure of scenario analysis is deemed not material, the issuer should disclose how the issue was assessed. If material, the issuer should proceed to second step: scenario analysis.

The Associations and their members would be pleased to undertake work to develop such a two-step approach, and suggested methodologies for each step, if deemed useful by the Task Force.

The Associations support the concept of developing standard suggested climate scenarios and time horizons for climate-related financial disclosures, but consider that further work would be required to make them useful and that, in any case, there would need to be flexibility about how such standards are applied by each issuer given its own facts and circumstances.

The Associations are concerned about the suggested disclosure of internal carbon prices[1] and propose that further work be done to consider whether common price metrics or references should be developed.

The final Recommendations should be clearly identified as making suggestions that may be used in meeting accounting standards, but should not be considered in any way to modify such standards or the available official guidance.

The Associations' views are aligned with the concerns of asset owners about the Recommendations applicable to them: while they should give consideration to the governance implications of their investments, they should not be deemed in any way to have any formal or legal obligations to police the climate policies of their investee companies.

The Associations generally support the goal of putting climate-related financial disclosures into mainline financial statements, but there will need to be evolution over time toward this goal, and it must be clearly understood that the recommended disclosures are not intended to expand the otherwise-applicable scope of audit requirements or legal liability.

[1] See Recommended Disclosure a) of Metrics and Targets in the "Guidance for All Sectors" in the Section C.2.d of the Recommendation report (page 21) and of the "Supplemental Guidance for Banks" in the Section D.1 of the Annex (page 22).

Comments on the Recommendations

The Associations have reviewed the draft Recommendations, the Technical Supplement on the use of Scenario Analysis in Disclosure of Climate-Related Risks and Opportunities, and the Annex on Implementing the Recommendations.

A number of themes arise in these documents, and the following comments are organized thematically to apply throughout the draft Recommendations.

1. **Materiality**

The statement is made in in section 2, at page 3, that "The FSB … emphasized that any disclosure recommendations by the Task Force … would need to incorporate the principle of materiality…". We note also from Appendix 6, page 64 of the Recommendation report, that "Disclosures should be eliminated if they are immaterial or redundant".

The Associations consider that the emphasis on materiality is fundamental to determining appropriate, useful disclosures, from the perspectives of both users and preparers.

It is important to be clear that materiality should be understood for purposes of the Recommendations to be applied as defined under regionally applicable legal and accounting definitions. That being said, the Task Force's guidance may be helpful for firms considering how to apply such materiality analysis to climate-related issues, especially given the forward-looking nature of the analysis.

The question of whether climate-related risk is material to a particular organization will depend on a number of factors, including the organization's business model and its exposure to climate-related physical and transition risks. The Task Force report, however, does not focus on how organizations should test for materiality.

We therefore suggest, as one of the areas for further work, developing guidance as to how organizations could efficiently make reasonably consistent determinations of whether climate-related risk is material to their business, recognizing that each organization must make its own determinations based on a full analysis of the facts and circumstances applicable to its business. Such guidance may be based on existing materials that some firms find useful, covering the various issues applicable to different sectors and types of issuers.[2]

It follows that if the determination is climate-related financial risks are not material, the organization would disclose the basis of that determination. There would then be no need to carry out detailed scenario analysis.

If the determination is that climate-related financial risks are found to be material, the organization would proceed to carry out scenario analysis as appropriate under the circumstances, taking into account the (final) Recommendations.

[2] An example would be the Sustainability Accounting Standards Board SASB Materiality Map (https://www.sasb.org/materiality/sasb-materiality-map/), which has been found useful for some preparers to provide a toolbox of material indicators adapted to each industry, and acceptable to the investment community. This Materiality Map could be a point of departure for future work.

The Associations believe that this two-step approach would be feasible and efficient, and we would be pleased to contribute to the development of simple, reasonably standard suggested methodologies for testing materiality for climate-related financial disclosure purposes.

We note also that the guidance on page 64 goes on to state that "… where a particular risk or issue attracts investor and market interest or attention, it may be helpful for the organization to include a statement that the risk or issue is not significant. This shows that the risk or issue has been considered and not overlooked."

We think that there is a significant possibility that this guidance could lead to pressure on organizations to disclose lengthy lists of non-material items merely for completeness, which is unlikely to be in the interests of users or preparers. In order to arrive at robust criteria of what to include in the list of non-material items, it may be necessary to consider whether further guidance is required as to how to meet the expectations in the language just quoted. As a general matter, boilerplate lists of immaterial issues that add to the length and complexity of disclosures should be avoided.

2. Scenario analysis

The Associations have comments on two aspects of scenario analysis:

- The choice of scenarios
- The methodology of analysis

2.1 Scenario analysis - choice of scenarios

The report states that "A critical aspect of scenario analysis is the selection of a set of scenarios (not just one) that covers a reasonable variety of future outcomes, both favourable and unfavourable. In this regard, the Task Force recommends organizations use a 2'C scenario in addition to two or three other scenarios, such as scenarios related to Nationally Determined Contributions, business-as-usual scenarios, or other challenging scenarios."[3]

The Technical Supplement states (in the final paragraph at page 3) that "in identifying scenarios that might work best, organizations may wish to internally develop their own scenarios."

While this observation is appropriate and should be maintained in the final text, the Associations suggest that, at least in the early stages of implementation, it would be appropriate for the Task Force to develop at least one 2'C baseline scenario for all organizations to use.[4] The use of a standard reference scenario or scenarios would make it easier for investors to compare disclosures from different organizations (all other things being equal), but further work is required as none of the widely available versions seems fully satisfactory. In addition, using a 2'C scenario as a baseline focuses on transition risks and may miss ongoing physical risk issues, for example to premises or to physical investments, and perhaps geographical differentiation questions, all of which will require further study. The necessary further work should involve firms from the financial services sector, in order to develop reference scenario(s) that would truly be useful for this purpose, and may require further work with climate scientists, especially

[3] See the Recommendation report, Section D.4 on page 29.

[4] Such a scenario should be defined to be as broadly applicable as possible. This may mean that it should be consistent with "well below 2 degrees" in conformity with the Paris Agreement, or it may be defined more generally, depending in part on the political uptake of the Paris Agreement, which may call into question whether it is the most appropriate point of reference.

insofar as physical risks beyond transition risks are implicated. Even if such a scenario is or scenarios are developed and widely agreed upon within the industry, firms would, nevertheless, need to be accorded considerable flexibility in how any standard scenario is used, especially as they begin to develop their approaches to climate-related disclosures and deepen their understanding of the issues for their own portfolios. The successful uptake of such scenario(s) will depend upon making the scenarios and the necessary data readily available on an open-source basis; such scenario(s) should not be costly to use or subject to permissions or authorization requirements.

It should be noted that even with suggested standard scenarios, there are likely to be additional financial, conjunctural or contextual assumptions that firms need to make in order to carry out their scenario analysis and apply it to their financial exposures and businesses. This point is covered at the end of section 3.2.

We have also had feedback from certain member organizations welcoming the Task Force recommendation of a small number of scenarios in addition to the baseline 2'C scenario[5].

In all cases, organizations should be understood to be free to choose to provide qualitative commentary or to use additional scenarios (either publicly available or their own scenarios) if considered necessary for investors' understanding.

In addition to consistency, a benefit of a standard reference scenario would be that the industry could more efficiently work on methodologies for analysis of the single standard scenario, rather than needing to develop methodologies for definition and governance of multiple climate scenarios.

2.2 Scenario analysis – developing methodologies to link macro scenarios to organizations

The Technical Supplement describes a number of publicly available climate scenarios. All of these scenarios are modelled at the macro level.

If we assume that a 2'C scenario is recommended, then the first challenge is how to apply this at the level of an individual firm or group. This challenge is noted in the Technical Supplement (first paragraph on page 5).

We suggest that the appropriate application of macro scenarios by individual financial firms or groups would benefit from industry-specific working groups to develop suggested methodologies and define parameters.

Firms have teams which conduct other forms of scenario analysis (eg stress testing for liquidity scenarios and for expected credit loss (ECL) accounting purposes), and it should be possible to leverage their expertise and experience.

It should be noted that when individual firms carry out their scenario analyses and apply them to their financial risks, opportunities, and projections, they may need to make additional assumptions, for example regarding parameters such as discount rates, economic cycles, or portfolios exposures that are specific to their business.

[5] See the Recommendation report, Section D.4 on page 29.

Such additional assumptions could also indicate risks reflecting uncertainty of direction or change of direction of current and future public policies, which may affect the analysis. Uncertainty in the policy environment may have significant impacts on strategy, risk management, and possible scenario results. The present report seems to assume the linear development of policies in one direction, but that assumption needs to be reconsidered at a time when major jurisdictions may make other policy choices, including withdrawing or changing tax inducements, subsidies, or other policy tools that may affect the financial analysis of climate-related investments or extensions of credit.

With respect to those additional assumptions, firms should be able to leverage insofar as possible any relevant scenario analysis already being utilized for stress testing, ECL provisioning, financial planning or other purposes. In financial scenario analysis, firms will need to add appropriate assumptions and consider different relevant scenarios, for example regarding interest rates, among other things to prepare for financial tail events. These assumptions and different scenarios may be built on top of the chosen scientific scenario for climate change.

3. Strategy

3.1 Strategy - time horizons

The guidance for all sectors (Strategy: Recommended Disclosure a)) states that organizations should provide "a description of what they consider to be the relevant short, medium and long term horizons, taking into consideration the useful life of the organization's assets or infrastructure, and the fact that climate-related financial issues often manifest themselves over the medium and longer terms". [6]

In principle it makes sense to allow organizations to define their own time horizons to reflect the useful life of their assets or infrastructure. However, the Associations think that this could make it more difficult for investors to compare disclosures between organizations. A possible solution would be to recommend common time horizons to apply across all sectors, or develop sector-specific time horizons (e.g. common time horizons for certain credit portfolios or types of insurance exposures).

The Associations have had feedback that financial institutions, as users of disclosures, would benefit from an aligned understanding of short, medium, and long-term horizons on the part of their client companies. At the same time, industry sectors and companies should not be constrained from defining additional, useful time horizons that reflect the lifetime of their assets or infrastructure, or if the generally applicable time horizons are inappropriate or misleading for some reason peculiar to their businesses.

This is another area where the industry could work with the Task Force to develop proposals for the banking and insurance sectors.

More generally, we note from Principle 5 and from page 31 of the Recommendation report that "organizations should strive to achieve comparability of results across different scenarios and analytical approaches." Given the forward looking nature of the analysis, the many unknowns, and the degree of judgment that each organization will have to apply, the aspiration of comparability across organizations, even within the same sectors and jurisdictions, will be hard to achieve (even if there is some degree of standardization of reference scenarios). This fact

[6] See the Recommendation report, Section C.2.b on page 19.

should be given more recognition in the discussion of the comparability goal in the Task Force's next report. The goal is laudable but the report should be more realistic about how difficult it will be to achieve, although it is possible to expect that projections, analysis, and disclosures practices may converge over time as firms learn from experience and as understanding of the risk presumably grows.

3.2 Strategy – scenario analysis

The guidance for all sectors (Recommended Disclosure c)) states that "organizations should describe how their strategies are likely to perform under various forward-looking climate-related scenarios and any resulting changes to their strategy and financial plans, risk management activities, or targets/metrics to mitigate risks and take advantage of opportunities."[7]

The Associations request clarification as to how this recommendation is intended to be applied. For example, suppose that an organization has considered strategies for tackling a number of climate-related scenarios. In such a case, is the intention that the organization would disclose how each of those strategies is likely to perform in each relevant scenario? Complex disclosures of various alternative strategies are likely to be burdensome for issuers and overly complicate disclosures for users. This kind of broad guidance needs to be more focused on disclosures of core issues that will be useful.

Furthermore, it should be made clear that any such discussion should not require disclosure of commercially sensitive or proprietary information. While it is true that the market's sense of what constitutes commercially sensitive or proprietary information is likely to evolve over time, firms must have the ultimate say on where to draw the line between appropriate disclosure of risks and strategies and disclosure that would compromise commercial issues or valuable information that belongs to the firm.

4. Metrics and targets

The guidance for all sectors (Recommended Disclosure a)) states that "organizations should provide the key metrics used to measure and manage climate-related risks and opportunities" and that "where relevant, organizations should provide their internal carbon prices as well as climate-related opportunity metrics such as revenue from products and services designed for a low-carbon economy."[8]

While it is important that investors be provided relevant information, once again the guidance should not require disclosure of confidential information which is commercially sensitive. For example, we are not sure that disclosure of internal carbon prices (or other prices, revenues, costs) would be appropriate from a commercial point of view, and, moreover, it may not necessarily be consistent with anti-trust or competition law.

We note from the report (paragraph 3 of Section E – sensitivities around transparency on page 38) that some organizations have already expressed concerns about disclosure of prices. Firms may find that investors would find useful disclosure of the level of conservatism applied, even if internal carbon prices are not disclosed.

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[7] See the Recommendation report, Section C.2.b on page 19.

[8] See the Recommendation report, Section C.2.d on page 21.

We would expect that different organizations may have different metrics and targets, depending on their business models. However, we think that there would be some merit in exploring whether there is a carbon price metric or proxy thereof that would be relevant to all organizations (or perhaps all organizations in a given sector). Such a metric could help comparability for users of the disclosures while avoiding confidentiality issues. We would be pleased to provide input to further work.

5. Accounting considerations; consistency with IFRS and US GAAP

We note from the Recommendation report (paragraph 7 of Section E – accounting considerations) that the Task Force considered the interconnectivity of its Recommendations with existing financial statement and disclosure requirements, noting that the two primary accounting standard setting bodies, the IASB and the FASB, have issued standards to address risks and uncertainties affecting companies.

In the second paragraph, the Task Force goes on to provide some commentary on what financial executives need to consider, for example in relation to asset impairments, additional liabilities, and underlying cash flow assumptions. It should be made clearer that such commentary constitutes suggestions for firms to use in their analysis and not a modification in any way of accounting standards or official accounting guidance or obligations.

We view the alignment of the Recommendations of the Task Force with existing financial statement and disclosure requirements as a key requirement for their application by businesses across all sectors, which should encourage adoption of the Task Force's Recommendations.

The extent to which the IASB and the FASB intend to adapt existing guidance or to develop new guidance on the basis of the Recommendations of the Task Force is their decision, but industry involvement in development of appropriate guidance to improve the comparability of disclosures would be welcome.

6. Scope of coverage; concerns of asset owners

Paragraph 9 of Section E of the Recommendation report states that "Consistent with existing global stewardship frameworks, asset owners should engage with the organizations in which they invest to encourage adoption of these Recommendations. They should also ask their asset managers to adopt these Recommendations." It is then noted that "several asset owners expressed concern about being identified as the potential 'policing body' charged with ensuring adoption of the Task Force's Recommendations by asset managers and underlying organizations."

We consider that the concerns of the asset owners are legitimate. While the Task Force can make the Recommendations, it should be clarified that no formal or legal responsibilities should be construed to arise from the Recommendations, and that asset owners are free to make their own judgments in light of their business models, clients, mix of business etc., as to their level of engagement. Moreover, the Recommendations should not be understood on this point to expand or impose any aspect of the "global stewardship frameworks", which have their own procedures and dynamics.

7. Location of disclosures

While the Task Force's goal of raising the profile of climate-related risks (and opportunities) by including related financial disclosures in financial statements is well-understood and supported by many firms, it should be made clearer that the placement of such disclosures in mainstream financial reporting is challenging and complex from several points of view. As the report acknowledges at page 36, disclosures via other forms such as sustainability reports or websites may be necessary interim steps, even given the goal of placing such disclosures in mainstream financial reports eventually. This is important because of the judgmental, forward-looking nature of the disclosures, and the fact that all firms are still developing expertise and their own approaches to such disclosures and may not be comfortable putting them in mainstream reporting (except where it is concluded that such disclosures would be required under otherwise-applicable legal or accounting requirements).

Some firms, however, have reservations about including such disclosures in required financial filings insofar as they do not relate to accounting standards or go beyond existing disclosure requirements. This is clearly a point that requires further discussion, and it may be that industry practice will need to evolve and converge over time on the most appropriate placement of all elements of climate-related fiancial information. [9]

Furthermore, firms note that some of the granularity around strategy and other recommended disclosures would not typically be seen in financial statements, so firms would want to consider how granular those disclosures should be, taking into account what would be useful for investors, lenders and other users. Given the broader desire not to burden the financial statements any further than necessary, given their already-existing complexity, a more nuanced approach to placement of climate-related financial disclosures should be considered. It may be more appropriate to put more of the details in Pillar 3, CSR, or other such public reports.

It needs to be made abundantly clear that the Recommendations are not intended to expand the scope of auditable information, or to create additional legal liabilities. This is especially important given the forward-looking, judgment- and scenario-based nature of the recommended disclosures. Even where included in mainstream reporting it should be understood that firms should be able to do so, as permitted by applicable law, in ways that do not expand the perimeters of audit or legal liability.

As another area for further work, the Task Force should examine potential legal exposures arising from the recommended disclosures: if such examination were to indicate increased exposure, that the Task Force should consider recommending regulatory provisions or guidance upon which firms could rely to eliminate any such increased exposure, to facilitate uptake of the Recommendations in the mainstream financials as intended.

[9] For example, one firm suggested it might be more appropriate to expand its corporate social responsibility (CSR) report to include additional data points. On the other hand, it was thought that some firms might start by disclosing some elements in CSR reports, and migrating toward the Management Discussion and Analysis or the equivalent over time, as their disclosure teams became more familiar with the recommended disclosures.

Conclusion

In short, the Associations applaud the Task Force's work to this stage, and are generally supportive; however, this letter suggests that further refinements will be needed, especially with respect to materiality and the placement of disclosures, in order for the final Recommendations to live up to their potential for usefulness.

If you have further questions on this response, please feel free to contact the undersigned, Hirokazu Masuoka (hmasuoka@iif.com) of the IIF, Richard Middleton (richard.middleton@afme.eu) or Sahir Akbar (sahir.akbar@afme.eu) of the AFME.

Very truly yours,

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