

12 February 2017

Task Force on Climate-related Financial Disclosures
Financial Stability Board
c/o PwC Research to Insight
Submitted via email to: tcf2017@uk.pwc.com

Re: Public Consultation: Recommendations of the Task Force on Climate-related Financial Disclosures

Dear Task Force Members:

CFA Institute¹ appreciates the opportunity to offer comments to the recommendations of the Financial Stability Board (FSB) Task Force on Climate-related Financial Disclosures (the “Task Force”).

OVERVIEW

The “Task Force” recently presented a report setting out their recommendations for helping businesses disclose climate-related financial risks and opportunities within the context of their existing disclosure requirements. The Task Force claims that without effective disclosure of these risks, the financial impacts of climate change may not be correctly priced – and as the costs eventually become clearer, the potential for rapid adjustments could have destabilizing effects on markets.

The Task Force believes that adoption of the recommendations will help ensure that climate-related financial issues are routinely considered in business and investment decisions and encourage an effective dialogue between companies and banks, insurers and investors. That will lead to smarter, more efficient allocation of capital, and speed the transition to a low-carbon economy. The Task Force lays out a number of climate risks and opportunities that can affect organizations’ revenues and expenditures, and possibly estimates of future cash flows, as well as their assets and liabilities in a number of ways.

CFA Institute is generally supportive of the work the Task Force has done in putting forth a disclosure framework for companies regarding climate change. We believe such a framework can help issuers better craft strategy that deals with the risk and opportunities of climate change and potentially give investors the tools they need to assess how climate change will impact the companies in which they invest over the mid to long-term. In the following sections we express our willingness to support further outreach activities and provide both general and specific comments on the Task force recommendations.

POTENTIAL ROLE FOR CFA INSTITUTE IN INVESTOR OUTREACH

There is an evolving and upward trending mindset shift within the investment industry around the importance of incorporating environmental, social and governance (ESG) factors into the investment process. There is a recognition that it is the asset managers’ fiduciary duty to incorporate ESG factors

¹ CFA Institute is a global, not-for-profit professional association of more than 145,900 investment analysts, advisers, portfolio managers, and other investment professionals in 162 countries, of whom nearly 139,900 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 147 member societies in 73 countries and territories.

into their financial analysis, security selection and asset allocation processes whenever such factors are material.

CFA Institute has long recognized the relevance of ESG information for a variety of investment strategies and the “integration of ESG into the investment process” is a core part of our CFA program curriculum and member continuing education material.

The informational efficiency and effectiveness of security pricing and asset allocation largely depend on the extent to which companies’ disclosures effectively convey material, informative, reliable and comparable information including ESG information. At the same time, many investors find “Environment” related disclosures within company reports to be inadequate and minimally informative for the purposes of facilitating the financial analysis and risk assessment of reporting entities. For example, our 2015 publication “[Environment, Social and Governance Guide- For Investment Professionals](#)” showed a limited use by investors of current disclosures related to “Environment” factors- signaling the perceived underlying deficiencies such as lack of comparability and consistency as well as the lack of valuation relevant information within current disclosures. Consequently, CFA Institute is supportive of initiatives that aim to enhance ESG reporting including the particular FSB effort to enhance disclosures of climate change risk factors.

Beyond this consultative outreach, we recognize that there is an ongoing need to galvanize significant investor support including going beyond “preaching to converted investors”. Hence, CFA Institute is willing to collaborate with the Task Force in any of its subsequent investor awareness outreach efforts and to engage and elicit buy-in from our members and other investors on the enhanced disclosure proposals. There is a likely need to further validate and illustrate via practical examples the potential usefulness of the recommended disclosures and for certain aspects of recommended disclosures such as the suggested scenario analysis, there is likely a need for refinement of the proposal attainable via an iterative interaction with investors. There will also be a need for ongoing education for many investors on how FSB work fits in with other efforts aiming to improve sustainability accounting. In sum, we stand ready to further support the Task Force.

GENERAL COMMENTS ON FSB TASK FORCE

The FSB Task Force initiative is timely as there is a significant gap between the macro-level aggregate data on the economic impact of some climate change factors (e.g. estimates of \$2 trillion of stranded assets due to regulatory measures to limit global warming to 2C) and the specific portrayal of climate change financial impacts by reporting firms particularly as there is a recognition that there are likely to be knock on effects spreading across multiple sectors including the financial sector. Any endeavor that can lead to more uniformity of disclosures and higher quality disclosures that are useful for investors is to be commended. However, these standards need to be used by issuers and investors for them to be effective. We therefore encourage the task force to continue to work with global issuers and investors in order to spur widespread adoption of the standards.

We support the following aspects of the proposals:

- *Guiding Disclosure Principles:* We support the Task Force’s proposed seven high-level disclosure principles as these ought to guide and are translatable to companies’ practical climate change disclosure choices.
- *Integrated Framework:* We support the proposed holistic and integrated framework that aims to portray the climate change risks, opportunities alongside the internal governance around these factors.
- *Supplemental Disclosures for Particular Industries:* We support the additional disclosure guidance for the specific sectors.

If adopted by companies, we anticipate that the Task Force proposed disclosures can inform investors ongoing short-term and long-term capital allocation decisions as well as highlight any potential systemic risk that may emanate from climate change patterns and/or related mitigation measures. The proposed framework ought to guide appropriate and material disclosures within particular industries and business models. We also wish to put forward the following general recommendations and observations:

- Prioritize communication of financial impacts on companies
- Need for distinction of timing of impacts
- Pursue alignment with other sustainability reporting initiatives
- Voluntary versus mandatory considerations
- Evaluate cost-benefit tradeoffs and impact on adoption

Prioritize Communication of Financial Impacts: We feel that there is need to prioritize disclosures that show the effect of climate change factors on companies rather than focusing only on those that show how a company is affecting the climate (level of GHG emissions) albeit that the latter factors may have second-order financial impacts (e.g. via carbon taxes, subsidies, credits).

It also helps if there is adequate contextual information of how any disclosed information could translate into potential financial effects on reporting entities (revenue, costs, assets, liabilities and cost of capital). We believe that the proposed scenario analysis can be a powerful tool in shaping the stories that companies tell.

Required Distinction of Timing of Impacts (immediate, near-term, medium-term and long-term): It will help investors if company reporting practices can dispel the misleading notion that climate change factors are either only relevant in the long-term or only in situations where adverse weather events occur in the immediate and/or near-term. There is a need for companies to be transparent about immediate term effects or events as well as those that crystallize over the medium and long term.

The Task Force recommendations highlight the difficulty associated with a prescriptive mapping of climate change risks to particular timeframes. Not to mention that companies have some way to go prior to suitably communicating relevant risk factors by time horizon- even in respect of risk factors, where reporting practices have been long established. Nevertheless, given the importance for investors to effectively evaluate the impact of climate change risk factors by time horizon- we encourage the task force to consider developing guidance that will encourage and help companies improve how they break-down climate change risk by maturity periods. For example, the bucketing of risks could be aligned with associated elements within the entity- specific strategic planning and risk management horizons.

Pursue Alignment with Other Sustainability Reporting Initiatives: We encourage the Task Force to explore how to align with other major initiatives (SASB and Integrated Reporting) or rather see how any incremental proposals that they are making (e.g. scenario analysis) are getting embedded in the work of others. There is a risk that the work of the Task Force will be duplicative of other efforts or will offer a competing standard already implemented or soon to be implemented that could lead to confusion among issuers and investors as to which standard to use. It appears that the Task Force has done this work to ensure that the standards are not duplicative and move the efforts of climate change reporting forward. However, we ask that the Task Force ensure that mechanisms are in place to ensure such efforts will continue in the future, as these standards may need to be revisited periodically to ensure that recommended disclosures keep pace with global best practice. In other words, an expanded menu of reporting choices can allow some companies to selectively cherry-pick across frameworks in a manner that compounds the current lack of comparable reporting.

Voluntary versus Mandatory Considerations: We wish to address whether this standard proposed by the Task Force should be voluntary or mandatory. A voluntary standard has the advantage of easier adoption

and the likelihood that more companies will adopt such a standard in the early days of that standard. A mandatory standard is more likely to produce more uniform disclosures if there is a viable enforcement mechanism to ensure companies comply with the standard. We feel that in the early days a voluntary standard makes sense, but we encourage the Task Force to pursue the more ambitious goal of a mandatory standard in the long-term in order to produce more useful data for investors.

Evaluate Cost-Benefit Trade-offs and Impact on Adoption: One potential impediment to the implementation of the Task Force's recommended disclosures is that they would apply to public companies, but not private ones. Therefore, private companies would be given a "pass" on climate change disclosures that their public company competitors may either agree to voluntarily or be compelled to through the adoption of a mandatory standard. Efforts such as those proposed here by the Task Force and by organizations such as the SASB and IIRC have done some of the heavy lifting by setting standards for disclosure to ease the burden of reporting for companies, but there is still a cost to companies in setting up systems to track and measure climate change data and to adopt the recommended disclosures set out by the Task Force. We therefore ask the Task Force to evaluate whether and the extent to which the cost of adopting the recommended disclosures potentially becomes an impeding factor to their adoption by public companies due to a perceived competitive disadvantage of doing so relative to non-public companies.

While we acknowledge that these disclosures may impose incremental compliance costs and be a source of perceived competitive disadvantages, we also anticipate offsetting benefits to be derived through the generation of these disclosures including strengthening the strategic thinking and internal governance around climate change risks and opportunities. It is also important to emphasize that communicating high-quality disclosures can be a signal to investors of a well-managed company and potentially bestow a transparency premium. In other words, the recommended disclosures can actually be a source of competitive advantage for companies that adopt them, if reporting is not viewed as being mainly a compliance burden.

It is beneficial for investors if a significant uptake and a critical mass of adoption of the recommended climate change disclosures occurs informed by a robust cost-benefit assessment that meaningfully considers all benefits (transparency premium, signaling of and actually being better-managed businesses) alongside costs of adoption. We also observe that the Task Force has set out a number of "Key Areas for Further Work" (page 34 of the report), but not much detail is given on how these standards could be applied to non-public companies around the globe. We encourage the Task Force to address this issue in their future work. We believe that a standard that is also useful to non-public companies, private equity, bond investors, real-estate investors and other stakeholders would be more useful to all companies and investors, and likely lead to wider adoption.

SPECIFIC COMMENTS

1. Climate Related Risks

CFA Institute believes that it is useful that the Task Force divided climate-related risks into two major categories: (1) risks related to the transition to a lower-carbon economy and (2) risks related to the physical impacts of climate change. This breakout of the risks associated with climate change allows issuers and investors to take a more nuanced and complete look at the near-term and long-term risks associated with climate change. There is not one over-arching risk from climate change, but a series of short to long-term risks that issuers should track and measure in order to better inform their strategic decision-making as well as informing their investors.

Transition risks are sub-categorized into the following:

- Policy and Legal Risks – Risks of changing legislation, reporting requirements exposure to litigation
- Technology risks – substitutions for current technologies, unsuccessful investment in new technologies
- Markets risk – changing customer behavior, increased costs for raw materials
- Reputation risks – negative stigma of industry, negative stakeholder feedback

Physical risks are sub-categorized into the following:

- Acute – Increased severity of extreme weather events
- Chronic – Changes in precipitation patterns, rising temperatures, rising sea levels

CFA institute finds the above framework that distinguishes transition and physical risks to be a good starting point for issuers and investors to frame their discussions around the issue of climate change. If possible, we would like more information about the process that led to the above list of risks (and the list of opportunities below) arrived at by the Task Force. We would like a window into the thought process that led to the list of risks and opportunities in the recommendations of the Task Force, and to learn if any potential risks and opportunities were left off of this list because they were not deemed to be a material climate risk or opportunity.

2. Climate-related Opportunities

The opportunities are categorized

- Resource Efficiency – more efficient transport, buildings, production processes
- Energy source – Lower emissions energy, new technologies, carbon markets, energy security
- Products and Services – climate adaptation, R&D, shifting consumer preferences
- Markets – New markets, public-sector incentives, development banks
- Resilience – Renewable energy programs, resource diversification

CFA Institute believes that this is a good beginning guide to help issuers better track and report on the material risks and opportunities brought forth by climate change. Such a reporting structure can also allow investors to focus on a set of specific risks and opportunities that they can track on a company by company as well as a portfolio basis. We encourage the Task Force to provide examples of disclosures currently in use by global issuers that meet the standards of disclosure discussed above. If there are not enough examples to meet such a request, we encourage the Task Force to create a document that will show issuers and investors what such disclosure would look like.

As noted above when discussing risks and opportunities outlined by the Task Force, we would like more information about the process that brought the Task Force to settling on these four broad recommendations. Where other recommendations considered? Why were they not included in the final recommendations? Again, if there are best-in-class examples of these disclosures already being made, we encourage the Task Force to reproduce them, or provide links to them, or to show us what best in class recommendations would look like.

Scenario Analysis and Climate-Related Issues

CFA Institute believes that scenario analysis can be a powerful storytelling tool to help issuers plan, and investors better understand the mid-term and long-term risk facing companies. Scenario analysis can be

particularly useful if there is a distinction between potential short-term versus long-term effects. We understand that some companies may be reluctant to publish the findings of their scenario analysis as these scenarios are by nature long-term guesses that are by definition uncertain and potentially inaccurate. There may also be reservations from a legal perspective with companies shy about opening themselves up to misinterpretations of scenarios by investors who may choose to see them as predictions by the company.

We believe these obstacles can be overcome by issuers clearly labeling their scenario analyses as such and including introductory language stating that such scenarios are not predictions, but simply part of a strategic exercise to help with planning and investor analysis. We also feel that it would be helpful if large institutional investors encourage issuers to use scenario analysis as a tool that will help issuers plan in investors better understand the long-term risks and opportunities that face the companies in which they invest.

Furthermore, as we contended in a 2014 publication ([*Forward-Looking Information: A Necessary Consideration in the SEC's Review on Disclosure Effectiveness*](#)), some of the forward-looking information required in scenario analysis is already embedded within the current accounting framework (e.g. impairment of long-lived assets, measurement of liabilities and estimates of contingencies). Hence, conducting and communicating a scenario analysis may simply be a matter of being more transparent regarding the amount and timing of any implicit assumptions/factors related to climate change. Alternatively, the exercise of a scenario analysis can help to ensure that any such factors are not being ignored within the measurement of relevant financial statement line items. Effectively, a scenario analysis can help to highlight the information risk associated with currently reported line items- particularly those that are influenced by climate change factors.

Conclusion

Should you have any questions about our positions, please do not hesitate to contact Paul Smith, CFA at paul.smith@cfainstitute.org, or Vincent Papa, CFA at vincent.papa@cfainstitute.org, or Matt Orsagh at matt.orsagh@cfainstitute.org.

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APPENDIX- DETAILS OF FSB RECOMMENDATIONS

High-Level Principles of Disclosure

These principles are:

1. Disclosures should represent relevant information
2. Disclosures should be specific and complete
3. Disclosures should be clear, balanced, and understandable
4. Disclosure should be consistent over time
5. Disclosures should be comparable among companies within a sector, industry, or portfolio
6. Disclosures should be reliable, verifiable, and objective
7. Disclosures should be provided on a timely basis

CFA Institute supports the seven high-level principles of disclosure that the Task Force put forward in order to help organizations in preparing their climate-related financial disclosures.

Four Main Recommendations

The Task Force made four broad recommendations to guide company disclosures concerning the topics of governance, strategy, risk management and metrics and targets.

Governance: Disclose the organization's governance around climate-related risks and opportunities.

Recommended disclosures

- a.) Describe the board's oversight of climate-related risks and opportunities.
- b.) Describe management's role in assessing and managing climate-related risks and opportunities.

Strategy: Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning.

Recommended disclosures

- a.) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.
- b.) Describe the impact of climate related risks and opportunities on the organization's businesses, strategy, and financial planning.
- c.) Describe the potential impact of different scenarios, including a 2°C scenario, on the organization's businesses, strategy, and financial planning.

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

Recommended Disclosures

- a.) Describe the organization's processes for identifying and assessing climate-related risks.
- b.) Describe the organization's processes for managing climate-related risks.
- c.) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management.

Metrics and Targets: Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities.

Recommended Disclosures

- a.) Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.
- b.) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.
- c.) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.

CFA Institute believes that this list is a good first step in providing companies with guidance that can lead to more uniform disclosure concerning the potential impact of climate change on a company's long-term performance.

The Task Force offers further guidance for all sectors concerning climate change disclosure later in the report that offers more detail. We find these recommendations helpful as they offer a succinct and concrete framework that issuers and investors can work with to better understand the risks and opportunities of global public companies concerning the issue of climate change.

Scenario Analysis and Climate-Related Issues

The Task Force notes that many of significant effects of climate change are likely to emerge over the medium to longer term and their timing and magnitude are uncertain. This uncertainty presents challenges for individual organizations in understanding the potential effects of climate change on their businesses, strategies, and financial performance.

In order to appropriately incorporate the potential effects in their planning processes, organizations need to consider how their risks and opportunities may evolve and the potential implications under different conditions, the task force suggests that firms use scenario analysis.

Scenario analysis is a well-established method for developing strategic plans that are more flexible or robust to a range of future states, though is relatively new in the world of climate change. The Task Force believes that organizations should use scenario analysis to assess potential business, strategic, and financial implications of climate-related risks and opportunities and disclose those in their financial filings.