

The FSB Task Force on Climate-related Financial Disclosures

What do its recommendations
mean for building and
materials companies?

June 2017



An introduction to the Task Force

TCFD established

The G20 Finance Ministers and Central Bank Governors recognised that without sufficient information, financial market participants are unable to analyse and price in climate risks¹. At a systemic level, mispricing of assets could lead to financial instability and capital allocation which is not aligned with the low carbon transition. As a result, in Dec 2015, Mark Carney, as Chair of the Financial Stability Board (FSB), convened the Task Force on Climate-related Financial Disclosures.

Objectives

The Task Force's objectives were to develop recommendations on climate disclosure for companies and investors that would i) promote better-informed investment, lending and insurance underwriting decisions, and ii) enable stakeholders to understand the financial system's concentrations of exposure to climate risks.

Recommendations

The industry-led Task Force has developed a set of recommendations on climate disclosure that draws upon existing frameworks but is crucially differentiated on two aspects. Firstly, the Task Force's emphasis is on financial disclosures. Secondly, and to aid that, the Task Force recommends the use of scenario analysis and disclosure of its results.

Adoption

After a 60 day consultation period from December 2016 to February 2017, the final recommendations were launched on 29 June 2017. Although they are voluntary, we expect that certain G20 countries will implement them over the course of 2018 and onwards.

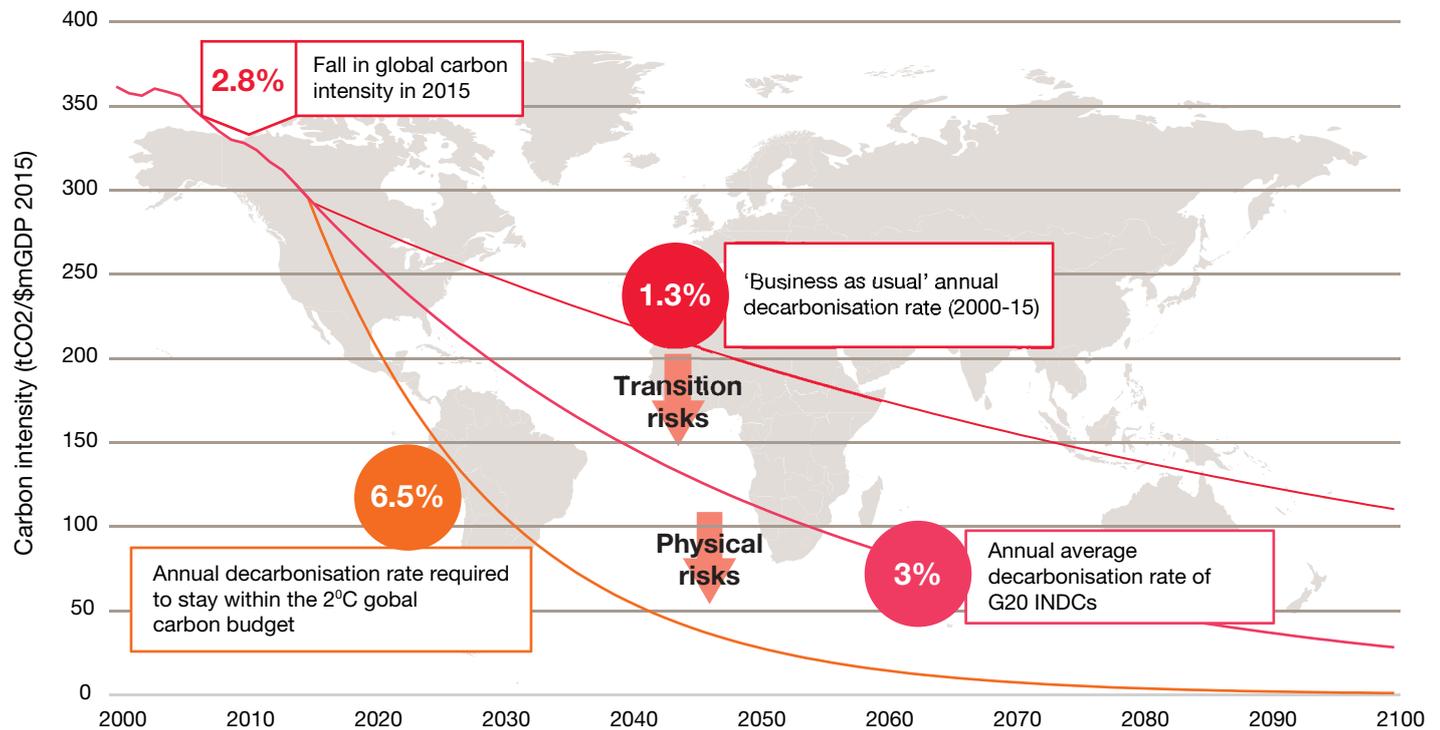
Highlights of the Task Force's final report



The Task Force recommends that disclosures are made in mainstream (i.e. public) financial filings and should be aligned with legislated thresholds on financial disclosure. 'Financial filings' refer to the annual reporting packages in which organisations are required to deliver their audited financial results under the corporate, compliance, or securities laws of the jurisdictions in which they operate.

The Task Force states that disclosures on the 'Strategy' and 'Metrics & Targets' recommendations should be subject to materiality tests, and in the case of building and materials companies, need only be disclosed where annual revenues exceed \$1 billion. Where these are non-material, they can be disclosed outside of annual report and accounts. The disclosures for governance and risk management remain for all companies regardless of materiality.

Decarbonisation pathways from the Low Carbon Economy Index



PwC's Low Carbon Economy Index shows the business as usual decarbonisations pathway compared to national commitments so far, and what more is needed to meet the Paris Agreement.

From Paris to policy risk...

- 01** The Paris Agreement consists of national and regional commitments to reduce greenhouse gas emissions over the next decade. The agreed reduction rate or decarbonisation pathways of the G20 countries is 3%. This is more than double the 'business as usual' rate over the last 15 years. It is equivalent to the UK's 'dash for gas' in the 1990s, and the recent US shale gas revolution.
- 02** Governments are already putting in place some of the policies and regulation needed to help them meet their commitments. Such policies are usually aimed at accelerating the transition towards a low carbon economy.
- 03** Such policies will undoubtedly impact companies operating within such sectors or where an important part of their value chain is reliant on such sectors. The question is which companies are better prepared and more resilient? How will their financial performance be impacted? The answers to these questions should form the basis of the due diligence you conduct.
- 04** We expect this policy trend to continue. Current commitments are insufficient to meet the required decarbonisation rate of 6.5%. The Paris Agreement states its ambition is to limit global warming to well below 2°C. To deal with this, the agreement contains a ratcheting mechanism, which effectively means the world can expect steeper greenhouse gas reductions in the future.

What's driving action?

November 2016: The Paris Agreement

Ratified in record time, entered into force 4 November

1

What is it?

197 governments have agreed to limit global warming to below 2°C

What does this mean?

Governments will be decarbonising their economies, a transition rate which is double the rate achieved over the last 15 years

How is this a risk?

Governments will be putting in place policies to decarbonise their economies. Companies will face transition risks in the form of policy and market developments, some will face more risk than others

June 2017: The FSB Task Force

The Task Force issued voluntary recommendations which are widely expected to be translated into regulation over time

2

Early adopters

Industry leaders and Task Force members are expected to be early adopters, many are already working to align their practices to the Task Force recommendations

Investors

Investors are making climate change a top engagement priority, and are prepared to use their voting powers to get management to disclose in accordance with the TCFD recommendations

Ongoing: Delivering better returns

Market leaders are pricing in the risks and opportunities of climate change to deliver better returns for their stakeholders

3

How does climate risk become business risk?

- Buildings and materials companies may be highly exposed to physical climatic changes. Climate change is already affecting the availability and pricing of major raw materials on which this sector relies.
- Climate risk can disrupt building and materials supply chains via impacts on availability of raw material and the integrity of supply chains themselves.
- Carbon tax will lead to higher oil prices which in turn will increase the price of production based on oil or dependent on fossil fuel.

Understand decarbonisation pathways

- The IPCC's AR5 (2014) estimates building and industry sectors combined to be responsible for just over 27% of anthropogenic GHG emissions. These sectors combined produce higher emissions than the energy sector (25%) which is currently the highest individual contributor and the primary focus for emissions reduction targets.
- Political decisions on the trajectories for the low carbon transition, for example, efforts towards reducing whole life environmental footprints of buildings through intelligent (passive) design which reduces energy demands may impact design choices.

Meet emerging stakeholder expectations

- Stock exchanges may promote or mandate adoption of the Task Force's recommendations, Members of Parliament of 30+ countries have written to the CEOs of stock exchanges around the world, calling for this.
- A growing number of investors such as Aviva and Blackrock have said that they will vote against the report and accounts of companies (and their Directors) which do not adopt the Task Force's recommendations.
- Swiss Re, the world's second largest reinsurer, has committed to adopting the Task Force's recommendations. This may well set the bar for what investors expect companies to disclose.

Why now?

1. Governments have committed to transition their economies towards a low carbon future. Policies will accelerate this transition.
2. The market is swiftly responding. First movers will be best placed to respond to trends and capture opportunities.
3. Investor expectations on the management and disclosure of climate risks will only increase.

What are the implications?

Scenario analysis

Using better data

The Task Force recommends the use and disclosure of scenario analysis in order to understand the climate risks and opportunities your company faces. This includes a 2°C scenario and the report also asks buildings and materials companies to disclose whether they have considered climate-related scenarios with 'major disruptions' from business as usual.

The results of scenario analysis may have subsequent impacts on accounting for assets and on financial projections.

This necessitates the integration of climate scenarios into any existing scenario and contingency planning that you currently undertake.



Risk management

Taking action

With an improved understanding of how your company may be *financially* impacted by climate change, you can start to manage the risks and capture the opportunities. This often goes beyond the more qualitative analyses of risk currently asked of by existing climate disclosure initiatives.

We think that integration of climate risk management into your existing risk management approach will be crucial to ensuring your company is well positioned in the low carbon transition. There are strategic, governance, systems and procurement implications for your consideration.

In the future, we believe that managing climate risk will become the norm and treated in the same way as any other material risk facing your business.



Financial reporting

Reporting on it

The Task Force takes climate reporting a step further in emphasising the importance of financial disclosures. In addition, it recommends that such financial disclosures are made in organisations' financial filings, where 'financial filings' refer to the annual reporting packages in which organisations are required to deliver their audited financial results under the corporate, compliance, or securities laws of the jurisdictions in which they operate.

This emphasises the view that climate risk is a financial risk that stakeholders should be informed about.

We think that this has implications which your audit and risk committees should be aware of.



A good governance structure should support all this



Are you ready?

Chairmen, CEOs and board members

- ✓ Do you have a clear picture of your company's exposure to climate risk beyond physical risks?
- ✓ Do you have a strategy and the governance structures in place to handle this risk and capture the opportunities?

CFOs

- ✓ Do your data and reporting systems provide adequate management information on climate risk and enable you to manage and report on them?
- ✓ Do they integrate into your existing reporting systems?
- ✓ Are you able to explain these risks to investors and regulators?

COOs

- ✓ Do you have effective risk management processes in place that integrate climate change into company-wide risk assessments?
- ✓ Does the risk committee have adequate oversight of climate risks?

Audit committee chairs

- ✓ Are you satisfied with management's reports on the effectiveness of the internal controls and risk management systems for climate risk?
- ✓ Are you satisfied that the financial statements prepared reflect any material climate risks and are complete and accurate?
- ✓ Is the audit committee sufficiently well-informed on the strategic, business and financial implications of climate change?

References:

- 1 Communique of the G20 Finance Ministers and Central Bank Governors Meeting in Washington D.C., USA (Apr 2015)

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