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The FSB Task Force on Climate-related Financial Disclosures
What do its recommendations mean for the energy sector?

June 2017

An introduction to the Task Force

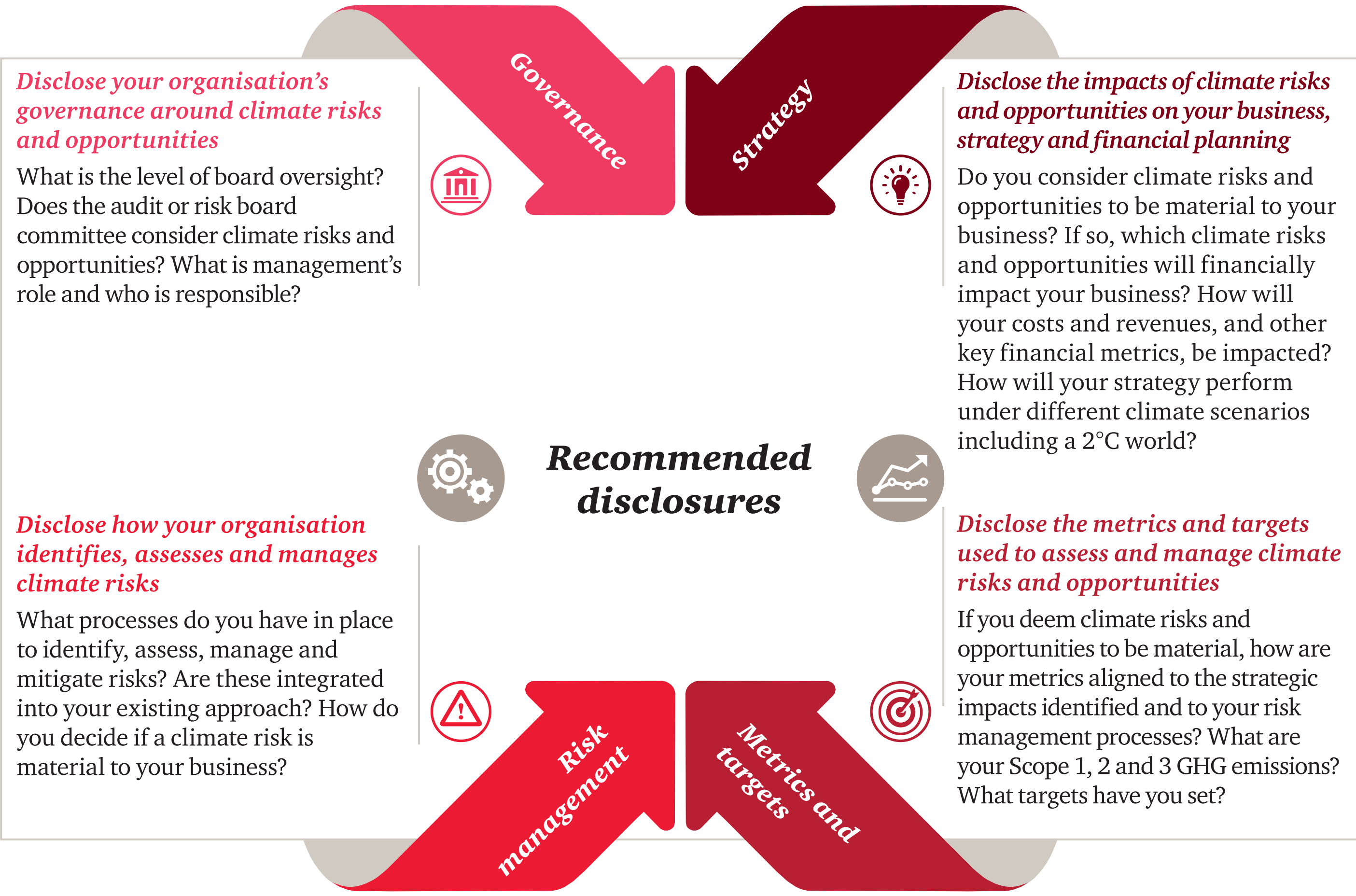
TCFD established
The G20 Finance Ministers and Central Bank Governors recognised that without sufficient information, financial market participants are unable to analyse and price in climate risks[1]. At a systemic level, mispricing of assets could lead to financial instability and capital allocation 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.

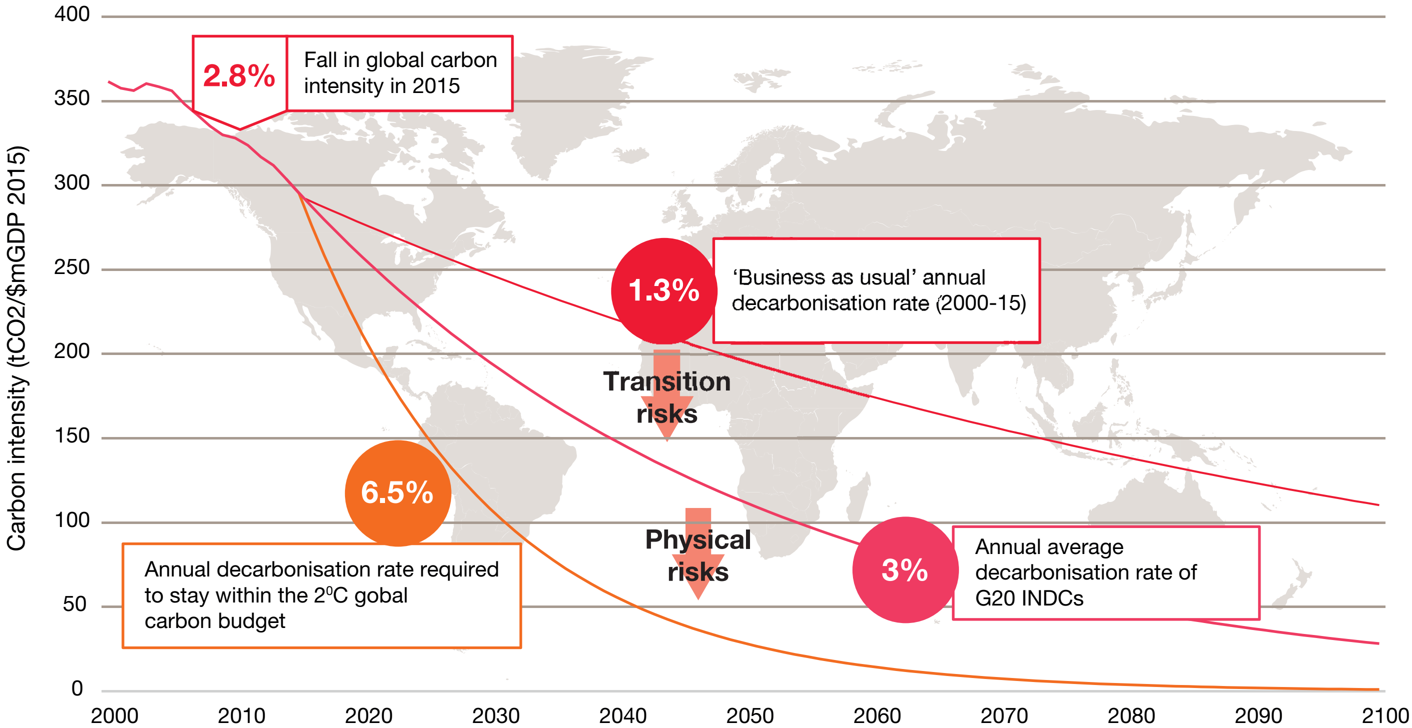
Highlights of the Task Force's final report



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 energy 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, by changing the risk profile of exposures to carbon-intensive sectors including fossil fuel energy, utilities and coal mining.

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 2ºC. 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

1

Ratified in record time; entered into force 4 November

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 economics. 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

2

The Task Force issued voluntary recommendations in 2017 which are widely expected to be translated into regulation over time

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

3

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

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.

How does climate risk become business risk?

- Companies with the long term infrastructure assets typical in the energy sector may be exposed to physical climate changes. Extreme weather events are already affecting many energy assets.
- A recent OECD report has warned that the commercial viability of some energy sector assets may be affected by both physical impacts e.g. water availability and extreme weather, and transition impacts e.g. policy and technological change[2].

Understand decarbonisation pathways

- The IPCC's AR5 (2014) report estimates the energy sector to be responsible for approximately 35% of anthropogenic GHG emissions; it is the biggest target for emissions reductions. However, it is also a sector that has significant opportunities for reducing carbon emissions with the right policy landscape.
- Political decisions on carbon pricing and the other incentives for low carbon investment will have direct impacts on the energy system and implications for efforts to develop carbon capture & storage (CCS), renewable electricity and heat systems.

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 financial institutions to disclose.

What are the implications for the energy sector?

Strategy

Using better data from scenario analysis

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 energy sector 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.

For example, based on the scenarios developed energy sector companies' income statements may need to consider carbon-pricing assumptions, including any internal carbon price applied, and the potential impacts of climate-related risks and opportunities – e.g. on research and development expenditures, adoption of new technology, and costs of key inputs.

Balance sheets may need to detail expected changes to reserves (e.g. additional investments, restructuring, write-downs, or impairment), and strategies to lower carbon-, energy-, and/or water-intensive operations. They may also need to detail how GHG emissions, energy, and water issues are taken into account in capital planning and allocation.

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.

For energy sector companies this may mean describing actions taken to prevent and mitigate any relevant climate-related risks or to take advantage of opportunities (e.g., procurement of low-carbon substitutes as inputs, development of lower-carbon products and services, investment in low-emissions technologies, and other activities to reduce emissions and increase resilience to climate-related impacts).

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

Financial metrics & targets

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.

Energy sector companies should consider providing key metrics to address potential financial aspects of shifting demand, cost of supply, reserves, and capital allocation driven by climate risk considerations.

This could be through reporting metrics such as investment in low-carbon alternatives (e.g., R&D, equipment, products, or services); current internal carbon price or range of prices used in financial planning and analysis; and breakdown of reserves and/or long lived assets and an indication of potential future emissions.

We think this has implications that 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)
2. OECD (2015) Divestment and Stranded Assets in the Low-carbon Transition
3. Chapter 7: Energy Systems. In: Climate Change 2014: Mitigation of Climate Change. Contribution of Working Group III to the Fifth Assessment Report of the IPCC

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