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# ***TCFD Phase II Report***

## A summary for business leaders

*Based on the version  
launched on 14 Dec for  
public consultation*

*January 2017*

## Context

The G20 Finance Ministers and Central Bank Governors are concerned that the financial implications of climate change are not adequately disclosed by companies to the market. Whilst companies might take into account the physical risks associated with climate change, the transition risks are more often ignored. Insufficient disclosure hinders the capital markets from making well-informed asset allocation and risk pricing decisions, and could pose a financial stability problem.

Recognising that the first step towards management of risk is the measurement of risk, **Mark Carney**, Financial Stability Board (FSB) Chair, created the Task Force on Climate-related Financial Disclosures (TCFD) in Dec 2015. The TCFD is chaired by **Michael Bloomberg** and consists of 31 industry leaders, including PwC Partner **Jon Williams**.

In Dec 2016, the TCFD released the Phase II Report which contains its disclosure recommendations. The recommendations seek to balance between the need to raise the bar for existing climate disclosure standards and the desire to achieve widespread adoption. Recognising that approaches will evolve over time, the Task Force also developed a set of 7 principles to underpin companies' disclosures.

We expect that the Report will be signed off by the FSB and presented to the G20 for adoption considerations by mid-2017. We believe that some countries will lean towards regulation and others towards softer approaches such as recommended guidance.





## The Report

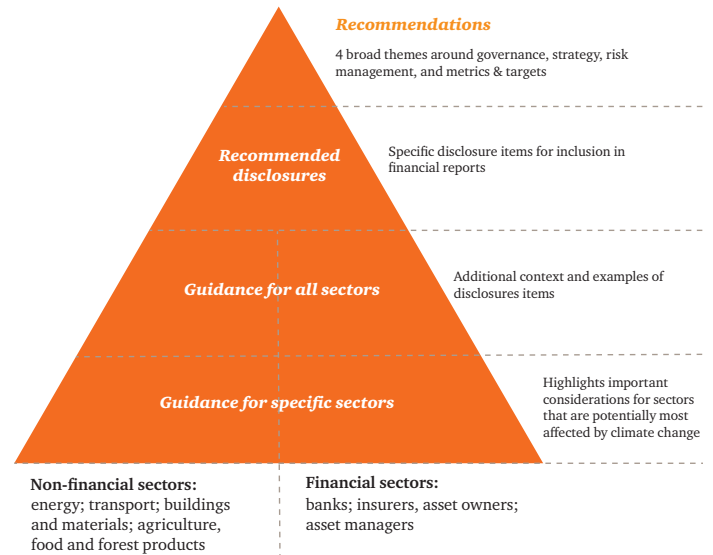
The Report consists of three sections:

1. the core recommendations
2. the implementation guidance
3. the technical annex on scenario analysis

The core recommendations are straightforward to adopt and well-recognised as the basis for disclosure on many risks. Below that sit the Recommended Disclosures which contain more specificity.

These are supported by:

- i) implementation guidance – a general set to be used by all sectors and 8 specific sets to be used by specific sectors (financial and non-financial) that are considered to be more at risk from climate change; and
- ii) an annex providing more guidance on scenario analysis.



## Scope

The Report's scope includes all companies with publicly issued debt or equity, regardless of industry. Asset managers and asset owners, such as pension plans, insurance companies, endowments and foundations are also included. The Report recommends that disclosures are made in financial filings and should be aligned with legislated thresholds on financial disclosure.

This is a logical approach, in our view, on the basis that any material financial disclosure should be put through the same rigorous governance processes regardless of whether the underlying driver is climate change or otherwise. It also allows companies to align their financial reporting with the legislated requirements depending on where they operate or are incorporated. This also would exempt smaller companies which may have a relatively smaller exposure to climate risks or less capacity at this stage to adopt the recommendations.

Given the TCFD's remit is from the FSB which is a G20 body, we expect that companies operating in the G20 countries will be asked to adopt the recommendations. This could also be driven by investor pressure, credit rating or equity valuation concerns or stock exchange listing requirements.





## Climate-related risks and opportunities

The TCFD moves understanding and acceptance of climate-related risks and opportunities beyond the traditional lens of physical impacts arising from severe weather events. The TCFD terminology suggests two broad types of climate-related risks – physical and transition risks. The table below explains further.

Type	Climate-related risk	Example
<b>Transition</b>	<b>Policy and legal:</b> the risk from emerging regulation aimed at addressing climate change or litigation risk	Canada will impose a carbon pricing scheme by 2018. This has cost implications for many industries, including car and industrial manufacturing, mining, oil and gas. It also has implications for the demand for carbon-intensive products and services, and therefore sector revenues.
	<b>Technology:</b> the risk from emerging technologies aimed at supporting the global low carbon transition	Innovations and technological progress, e.g. in renewable energy or electric vehicles will have implications for the business models of many companies in related sectors, reducing costs of electricity production or increasing capital or research and development expenditure as companies look to compete and respond.
	<b>Market:</b> the risk from shifting supply and demand curves as economies react to climate change	As the costs of renewable energy drop, the world has seen a corresponding increase in its adoption. In 2015, renewables represented 54% of all new capacity installed globally – the first time it has pulled ahead of fossil fuels <sup>1</sup> .
	<b>Reputation:</b> the risks of damage to brand value and loss of customer base from shifting public sentiment about climate change	A global movement has seen commitments from investors responsible for \$5 trillion to pledge divestment from fossil fuel companies in one way or another <sup>2</sup> . This could contribute to a reduction in capital available for such companies.
<b>Physical</b>	<b>Acute:</b> the risk of increasing severity of weather events	A leading British supermarket chain has found that 95% of its supply chain is vulnerable to disruption by climate change impacts with an estimated £360m of value at risk <sup>3</sup> .
	<b>Chronic:</b> the risk of longer term changes in weather patterns and other climate change impacts	

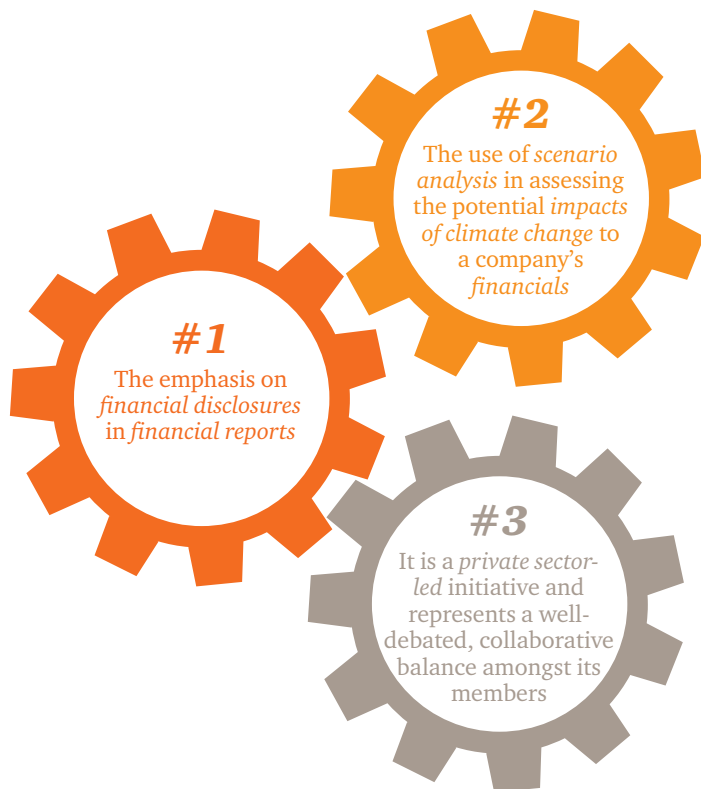
<sup>1</sup> Global Trends in Renewable Energy Investment 2016, UNEP FI and Bloomberg New Energy Finance  
<sup>2</sup> The Global Fossil Fuel Divestment and Clean Energy Investment Movement, 2016, Arabella Investors  
<sup>3</sup> The Challenge of a Changing Climate, 2014, ASDA





## What makes the TCFD different?

In our view, three factors differentiate the TCFD Recommendations from the many existing sustainability and climate reporting frameworks.



**Firstly**, there is the shift in emphasis from sustainability metrics only, such as water recycling rates or landfill waste reduction, to financial disclosures, such as the impact of carbon regulation to consumer demand for a company's products, or the supply chain disruptions likely to occur from severe weather events. The Report references disclosure of financial impacts such as increased operating costs, reduced revenues, impaired assets, more costly insurance premiums, higher capital costs and early asset retirement, to name a few.

**Secondly**, we believe the recommended use of scenario analysis will pose an interesting intellectual challenge for companies. The disclosure of its results will fill the growing gap between investor expectations and company disclosure, and go some way towards enabling more well-informed financial decisions to be made by stakeholders.

**Lastly**, the TCFD membership is drawn from the leaders and forward-thinkers of the private sector, with a balance across industries and roles. This enabled robust discussion and challenge between members, leading to the right balance being struck on tone and content. This should pave the way for widespread adoption of the Recommendations.





## What are the core recommendations?

The core recommendations are based on the broad themes of governance, strategy, risk management, and metrics and targets. These are well-known to risk practitioners and corporate reporters, and commonly accepted as a way of reporting on many types of risks.

Here we highlight some of the more interesting disclosure items.

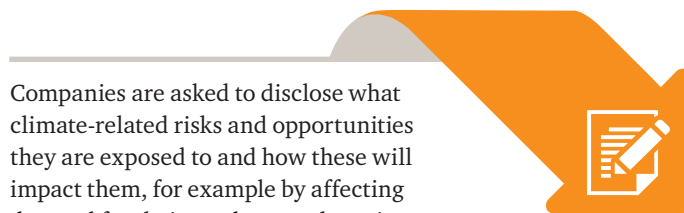


### Governance

Companies are asked to disclose the extent of the board and management's oversight of climate-related risks and opportunities. This includes the process and frequency by which board committees, such as the audit committee, are kept informed and how climate change issues are considered when reviewing the company's performance, strategy and business plans. The audit committee's role in overseeing climate-related financial disclosures should be the same as with any other financial disclosure.

### Risk management

Companies are asked to disclose how they identify, assess and manage climate-related risks and specifically, how the management of climate-related risks is integrated into existing risk management frameworks.



### Strategy

Companies are asked to disclose what climate-related risks and opportunities they are exposed to and how these will impact them, for example by affecting demand for their products and services or their supply chain which potentially lead to impacts on their income statements and balance sheets. Most importantly, companies are asked to conduct forward-looking scenarios on how their businesses will perform in a world where global warming is limited to 2 degrees Celsius.

Companies are expected to disclose metrics and set targets that are aligned with the risks and opportunities they have identified as material for their business. The report also specifically asks for companies to disclose their Scope 1 and 2 greenhouse gas emissions, and if appropriate, Scope 3 as well. This is in recognition of the fact that rising emissions are still a key driver of global warming, and big emitters are, arguably, subject to greater transition risk.

### Metrics and targets



It is up to companies to determine the materiality of any climate-related risks or opportunities they face and to disclose their assessment. The company's stakeholders, particularly investors and ratings agencies, will increasingly expect disclosure and companies will need to disclose or explain why there is no disclosure.



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## Key questions for companies

*As companies look forward into 2017 and beyond, we believe 5 key considerations should feature in your plans.*

### **1 Do you have the right strategy and governance structures in place?**

In our view, climate-related risks and opportunities should be managed no differently to any other types of risks and opportunities. For many companies, climate-related risks and opportunities will be relevant to functions such as strategy, finance, risk and reporting. This should therefore be a relatively simple and potentially valuable action for most companies.

### **2 Do you have an understanding of how climate change could financially impact your business?**

This involves at its simplest level a materiality assessment, and in greater depth, the use of scenarios to anticipate potential impacts to income statements and balance sheets. As the use and disclosure of scenario analysis increases in the market, this will become the standard expectation from investors and other stakeholders.

### **3 Is your business prepared to respond to the identified climate-related risks and opportunities?**

Market leaders are looking to distinguish themselves commercially on this aspect – by identifying the ‘winners’ and ‘losers’ of a global economy impacted by climate change and transitioning towards a low carbon future. Investors will be looking to put their money where they believe they can receive the greater risk-adjusted returns.

### **4 Are you in a position to meet investor and stakeholder demands for climate-related financial information?**

There is a shift in emphasis from reporting on your business’s impact to climate change to reporting on the financial impact of climate change on your business. Investors are increasingly expecting to see this sort of financial disclosure and we believe that they will use the TCFD’s report to demand it. This implies that climate-related financial disclosures will have to go through the same rigour and governance as standard financial reporting.

### **5 Have you got the right data and systems in place?**

The management and reporting of climate risks and opportunities will require re-thinking how your company collects and analyses data, and how such data is fed into the systems and processes which underly the business decisions made by your employees. Although the temptation is to place an ‘add-on’ onto existing approaches, we think that in the long term, taking an integrated approach will help to streamline processes and reduce costs.



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## Contacts



**Jon Williams, Partner**

T: +44 (0)20 7804 3978  
E: jon.d.williams@pwc.com



**Stephanie Chang, Asst. Director**

T: +44 (0)20 7804 6515  
E: stephanie.y.chang@pwc.com



**Matthew Johns, Manager**

T: +44 (0)20 7213 4076  
E: matthew.w.johns@pwc.com

Identifying, assessing, managing and reporting on your climate-related risks and opportunities will strengthen your core business and help meet growing stakeholder expectations.

Please contact us if you would like to learn more about the tools and services we can provide to support you.

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