Observations on the TCFD recommendations

In December 2016 the Task Force on Climate-related Financial Disclosures (TCFD) released its Phase II draft recommendations for a 60-day public consultation period which closes on 12th February 2017.

CDP welcomes the TCFD's recommendations. We recognize they have the potential to further 'normalize' climate information in companies' mainstream financial filings. The TCFD has created the opportunity to raise climate-related issues from the CSR department to board level and more investors and companies are engaging with climate risk and action.

Nearly 6000 companies disclosed through CDP in 2016, representing some 60%[1] of global market capitalization. However, many companies have yet to align business strategies with the requirements of the Paris agreement. The TCFD recommendations bring to the forefront techniques including scenario analysis that will enable better information for investors to assess risks. We thank the Task Force for their leadership and see this as a potentially game-changing initiative.

CDP is providing a formal submission through the online TCFD consultation process; this document supports our submission to provide high-level insights on the Phase II draft. In support of the work by the TCFD, we encourage all parties to submit their input before the deadline. The formal submission process can be accessed here.

CDP has identified nine core areas that we believe require further action to maximize success:

1. Mandatory disclosure;
2. Scenario analysis;
3. Comparability;
4. Fossil fuel subsidies;
5. Geographic reach;
6. Future proofing;
7. Clarification of existing legal duties;
8. Carbon footprinting for financial institutions; and
9. Carbon footprinting for non-financial institutions.

In recognition of others in the community we would also like to highlight the submissions provided by CDSB, We Mean Business, WWF, 2 Degree Investor Initiatives (2DII), ClientEarth, PRI and the Corporate Reporting Dialogue (CRD) with whom we maintain open engagement channels and value their expertise.

[1] CDP Climate Change Report 2016 - https://b8f65cb373b1b7b15feb-c70d8ead6ced550b4d987d7c03fcdd1d.ssl.cf3.rackcdn.com/cms/reports/documents/000/001/228/original/CDP_Climate_Change_Report_2016.pdf?1485276095

1. Mandatory disclosure

The Task Force has provided the opportunity to drive climate-related discussions out of the CSR department and in to boardrooms globally.

The TCFD's voluntary recommendations are aimed at the integration of climate information into mainstream fillings and driving a broader understanding across boards and investors. However, this information will not be useful to investors unless they are able to work with a full set of comparable information, generated as a result of universal disclosure by companies.

The question is what means are necessary to create universal disclosure? While companies disclose to CDP at scale, to date, it has not been possible to achieve universal disclosure through voluntary methods. For example, in the UK c.95% of the FTSE 100 report climate information to CDP, but only around two thirds of the FTSE 350[2]. In addition, the quality of information available to investors is important, for all of the principles for effective disclosures identified by the TCFD recommendations[3] (relevant, specific and complete, clear, consistent over time, comparable, reliable and timely). As a result of our direct experience of working to encourage companies to disclose on a voluntary basis[4], we are advocates of mandating and enforcing universal company disclosure to obtain consistent, comparable and high-quality information and reach companies who resist voluntary norms. We believe policy intervention is key in stimulating action through driving change in corporate behavior. The governments of the G20 should take this in to account when considering the TCFD's recommendations.

2. Scenario analysis

CDP considers scenario analysis as a top priority for organizations in the transition to a low-carbon world, particularly across the high-emitting sectors, namely oil and gas and utilities. The TCFD's work on climate scenario analysis will aid in mainstreaming scenarios and deserves recognition. To maximize uptake, CDP has identified details for scenario analysis that should be addressed in the final release of the recommendations:

a. 1.5°C/well-below 2°C scenarios

We believe that the TCFD needs to acknowledge the shortfalls of focusing on 2°C scenarios which do not correlate with the Paris Agreement's goal of a well-below 2°C world. We encourage the Task Force to cite the recognized gaps in the recommendations through referencing the IEA 1.5°C scenario (expected release in June 2017) as an important next step in scenario analysis in the transition to a low-carbon economy.

[2] CDP Climate Change Report 2016 - https://b8f65cb373b1b7b15feb-c70d8ead6ced550b4d987d7c03fcdd1d.ssl.cf3.rackcdn.com/cms/reports/documents/000/001/228/original/CDP_Climate_Change_Report_2016.pdf?1485276095

[3] Recommendations of the Task Force on Climate-related Financial Disclosures - https://www.fsb-tcfd.org/wp-content/uploads/2016/12/16_1221_TCFD_Report_Letter.pdf

[4] Pitfalls of Climate-related Disclosure - https://b8f65cb373b1b7b15feb-c70d8ead6ced550b4d987d7c03fcdd1d.ssl.cf3.rackcdn.com/comfy/cms/files/files/000/000/784/original/Pitfalls-of-Climate-Related-Disclosure.pdf

b. Transition plans

2°C and well-below 2°C scenarios are precursors to companies developing effective transition plans that ensure the company will both survive and adapt to a below 2°C world. This approach also minimizes, as far as is reasonably possible, the company's own contribution to climate change. The disclosure of a transition plan enables investors to monitor the company's progress against its plan. We recommend adjusting the TCFD guidance to reflect this.

CDP's 2017 Climate questionnaire asks organizations to detail their alignment with the Paris agreement, including details on their transition planning[5].

c. Scenario analysis parameters

The TCFD recommendations require organizations to disclose their findings from scenario analysis tests, but do not require the identification of parameters used to reach these findings. Science Based Targets[6] (SBTs) and Carbon Pricing[7] should be incorporated into the TCFD recommendations based around scenario analysis as they provide a pathway and route to monetization of energy and climate risk to reach a well-below 2°C world. This creates an actionable pathway on the basis of the risks companies are running and is missing from the current report.

If the TCFD does not wish to incorporate this suggestion directly into the recommendations, we encourage the Task Force to consider referring organizations to CDP's platform and CDSB's framework to validate successful disclosures.

d. Reference scenarios and a community sharing platform

The freedom to use different models has both advantages and disadvantages with different models more or less applicable to different industries. The disadvantages are that companies may choose models that are more favorable for them to continue along a business-as-usual trajectory. This would in turn mean a potential delay in the preparation of the company's own scenario and transition planning. We therefore recommend a 'comply or explain' policy in relation to use of the IEA's 450[8] and 2°C scenarios. However, recognizing that these may at the moment have little to say about specific sectors (such as cement and steel), we also recommend the setting up of a 'scenarios warehouse' where scenarios with more specific applicability or using different parameters and assumptions could be shared.

[5] CDP Climate Questionnaire 2017 – Q2.2a
[6] Science Based Targets Initiative - http://sciencebasedtargets.org/
[7] Carbon Pricing Corridor Initiative announcement – https://www.cdp.net/en/articles/media/industry-leads-new-initiative-to-revolutionize-carbon-pricing-for-investors
[8] IEA 450 Scenario: Methodology and Policy Framework - https://www.iea.org/media/weowebsite/energymodel/Methodology_450_Scenario.pdf

3. Comparability

The TCFD references a number of frameworks and metrics that align with their recommendations. However, providing such a broad range for organizations to consider can lead to issues of comparability where instead there should be some directional prescription for companies. With such a broad selection of metrics, distilling what is relevant will be critical.

Alongside issues with organizational comparability there are similar concerns with year on year comparability. In order to achieve implementation of the recommendations, structure is key in aiding comparability – CDP's platform provides this detailed structure through measurement, benchmarking, Science Based Targets and the Carbon Pricing Corridors Initiative[9]. The recommendations do not outline a pathway for companies or investors to track and benchmark performance, or address fundamental issues around measurement.

In addition, the recommendations do not specify who will be responsible for enforcing the quality of reporting, and how companies will receive feedback on whether their disclosures are fit for purpose, acceptable and/or of high enough quality. CDP is committed to a sector-based disclosure strategy embedding the TCFD recommendations.

We are uniquely placed to provide a comprehensive metric analysis platform with built-in flexibility for individual tailoring for organizations, with the capability for companies to better understand how they are benchmarking against their industry relevant peers. Investors are increasingly asking for this sector level data and benchmarking to drive investment decision-making. CDSB's guidance further supports companies in creating consistent, comparable mainstream climate reports.

CDP would also suggest the inclusion of more detailed roadmapping in the recommendations, to signpost which disclosures companies should attempt first and go from there – CDP has roadmapping documents already available that add value to this approach[10].

CDP considers that pushing for mandatory reporting (and enforcement) is a vital next step in order to drive universal, high quality, comparable and consistent reporting. We will continue our efforts to this end.

4. Fossil Fuel Subsidies

In their recommendations on factors to consider when evaluating the exposure to transition risk, the TCFD has recommended that organizations most significantly affected by transition risk (e.g., fossil fuel-based industries) should consider in-depth scenario analysis, where subsidies or taxes may have a particularly direct effect. The TCFD guidelines should suggest the consideration of the impact of fossil fuel subsidies, and what their likely removal would mean for the reporting organization's businesses and operations.

[9] Carbon Pricing Corridor Initiative announcement – https://www.cdp.net/en/articles/media/industry-leads-new-initiative-to-revolutionize-carbon-pricing-for-investors
[10] See CDP's climate, water and forests reporting roadmaps

5. Geographic reach

With a largely US/Euro-centric Task Force membership, the TCFD needs to ensure stakeholders adopt the recommendations to address the call for global reporting frameworks that are universally relevant. To date, developing countries have been under-represented in the TCFD process[11].

Developing countries are vulnerable to some of the most significant effects of climate change and have the greatest financing needs to mitigate these challenges and secure sustainable development.

Emerging economies are likely to have concerns about whether disclosing climate impacts and risk may create additional cost and burden in the future or may reduce their access to capital; there are strong arguments which can be made to say that costs can be seen as investment opportunities in future performance and that capital flows will increasingly flow to low-carbon targets. It will be helpful for the TCFD to be seen to acknowledge this in its final recommendations.

6. Future proofing

The recommendations from the Task Force run the risk of being a snapshot in time and future proofing the recommendations is key. Disclosure and climate action are evolving processes based on the latest science, developments, and investor actions.

CDP is an integral part of global efforts to meet the well below 2°C world and enable market actors to track progress against these goals. Together with CDSB we help companies perform in, and adapt to, a low-carbon world where collaboration with other players is key. We are working with over 200 major multinationals committed to setting SBTs and over 1,200 companies which are adopting internal carbon pricing. We are more than just a facilitator for the TCFD recommendations, we are the markets' institutional memory in the drive for better, more effective disclosure and climate change performance. CDP will continue to drive the evolution of disclosure in the direction of achieving a low-carbon world.

7. Clarification of existing legal duties

To avoid undermining organizations' compliance with their existing legal duties, the TCFD Report should clarify that many G20 countries already require the disclosure of climate-related risks in mainstream financial filings and corporate reports. This is jurisdiction specific. Accordingly, the TCFD Report should make it clear that organizations need to obtain their own legal and accounting advice about their existing disclosure obligations.

[11] Task Force on Climate-related Disclosures Phase I Report - https://www.fsb-tcfd.org/publications/phase-i/

8. **Carbon footprinting for financial institutions**

We believe that the disclosure of the metric "carbon footprint of investment/Million asset under management" is not an accurate measure of risk given that the normalization factor can vary significantly for reasons unrelated with the alignment of assets with a low-carbon transition. Therefore, normalizing the carbon footprint by Million AUM introduces significant distortions on the significance, interpretation and usability of the indicators which makes it impractical for use, even counter-productive as a tool to manage climate-risk exposure, and therefore should be removed from the recommendations. We appreciate that the TCFD have recognized the limitations in this recommendation.

9. **Carbon footprinting for non-financial institutions**

The reference to the carbon footprint in the general sector guidance should be expanded to include other indicators. We recognize there is disagreement about carbon footprinting as the most meaningful indicator for non-financial reporting, and is an input to other relevant composite indicators. To the extent that carbon footprint is meaningful, it should be forward- and backward-looking, activity based (e.g. normalized by products / services sold), and reference Science Based Targets. We recommend adjusting the TCFD guidance to reflect these elements.

Closing Remarks

Alongside our peers in the reporting community, CDP welcomes the TCFD recommendations for mainstreaming climate disclosures. To maintain their relevance for the future we advise the implementation of a structured review process. This will also provide the opportunity for further clarification on key issues such as scenario analysis and metrics to be used for Financial and Non-Financial institutions - this is likely to require that the recommendations are given an institutional home after the immediate work of the Task Force has concluded.

We will continue to work with investors, companies and cities in the drive for mandating regulatory disclosure. We will also continue to innovate in the 'next phase of experimentation' to 2020 and beyond, taking the best developments in science, benchmarking and new technologies forward such as the role of XBRL in overcoming climate-related reporting challenges[12] and the pitfalls of climate-related disclosures[13]. This will ensure companies and investors better understand climate risk and can better prepare for a more sustainable world for today and tomorrow.

CDP advocates the implementation of the TCFD recommendations; in reflection of this our Reimagining Disclosure initiative will be fully aligned with the recommendations by the end of 2018. It is our mission at CDP to drive global disclosure and ensure accountability and progress tracked against a well-below 2°C pathway.

[12] The role of XBRL in overcoming climate-related reporting challenges – https://b8f65cb373b1b7b15feb-c70d8ead6ced550b4d987d7c03fcdd1d.ssl.cf3.rackcdn.com/comfy/cms/files/files/000/000/786/original/XBRL-Paper.pdf

[13] Pitfalls of Climate-related Disclosures – https://b8f65cb373b1b7b15feb-c70d8ead6ced550b4d987d7c03fcdd1d.ssl.cf3.rackcdn.com/comfy/cms/files/files/000/000/784/original/Pitfalls-of-Climate-Related-Disclosure.pdf