Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

The Task Force on Climate-related Financial Disclosures Report Consultation

13 February 2017

Response of:

European Investors' Association IVZW

Contact persons:	P.M. (Paul) Koster S. (Sibe) de Bok
Address:	Rue du Sceptre 63aq 1050 Brussels Belgium
Telephone:	+32 (0) 2 446 00 46

Introduction

The European Investors' Association – European Investors – is a not-for-profit and member-based organisation that aims to strengthen the representation of investors in Europe. European Investors represents investors in regulatory discussions, engages on behalf of (long-term) investors with listed companies, and initiates class actions to reclaim losses incurred by investors as a result of unlawful behaviour. All in all, European Investors' objective is to enhance trust in European capital markets by promoting transparency, engagement and accountability.

European Investors is very supportive of the work that is being undertaken by the Financial Stability Board's Task Force on climate related financial disclosures ('TCFD'). Organisations that attract capital from investors need to ensure adequately disclosure of the financial implications of the climate-related risks and opportunities that they face. Despite the existence of numerous frameworks, disclosure at the moment is not sufficient. Also, we note a serious lack of consistency among the different frameworks and how they are implemented. As a result, investors cannot compare the disclosures of organisations with their peers. European Investors hopes and believes the recommendations of the TCFD will contribute to more comparable and decision-useful information being provided to end-investors and to other parties along the investment chain.

Further, climate change is one of the key areas that European Investors has identified in the run up to the 2017 AGM season and to which it would like to see more attention given by listed companies. Through its presence at AGMs and one-on-ones, European Investors will go into dialogue with these companies on improvements that could be made in the way management approaches climate related risks and opportunities and disclosures on their financial implications. The TCFD recommendations provide us with an important source of reference in this regard.

General comments

The awareness among investors about the implications of climate change is, after the adoption of the Paris Accord, probably greater than ever before. Through our constituents (retail and institutional investors) we notice a great need for ways to make the implications of climate change on their investments transparent and measurable. **Disclosure of the information recommended by the TCFD can and will in our opinion be useful for to this end and will enhance the ability of our constituents to make well-informed investments decisions with a clear focus on long term value creation.** Particularly, the recommended information on financial planning and risk management is paramount to investors.

European Investors thinks a level playing field is key to the success of the framework. European Investors is concerned that some organisations might prove to be reluctant to disclose certain information if their peers do not do the same, especially when it involves forward looking projections that put the organisation's business model into question. Investors can of course try to exert influence on such organisations. However, they can only do so effectively if the framework has already acquired 'critical mass', meaning that investors can point to other organisations within the sector and make a credible threat of shifting their capital. Further, organisations using public equity/debt might be reluctant to adopt the recommendations if their private or state-owned counterparts, which do not fall within the scope as suggested in the report, do not do the same. An *un*level playing field might also arise among different jurisdictions, with potentially less willingness to adopt the framework in emerging economies within the G20.

In view of the aforementioned observations, European Investors thinks more binding measures are a necessity, particularly in relation to the impact of climate related on the balance sheet and income statement of organisations. Close collaboration with the International Accounting Standards Board and Financial Accounting Standards Board is in our view a prerequisite for the effective implementation of a mandatory framework, embedded in the law of all G20 jurisdictions.

Furthermore, we think the TCFD could be more outspoken about the need for all companies to adopt the framework. For example, we note that the Task Force, under “Key Issues Considered and Areas for Further Work” suggests that, taking into consideration the sensitivities of transparency, disclosure via other forms (e.g. website) may be an interim step on the path to disclosure in financial fillings. We feel that such caveats underplay the relevance and urgency of the matter at hand. Improper accounting of the financial impact of climate change is detrimental to the efficient functioning of capital markets and the trust therein of investors.

Specific comments

<u>1.1 Financial planning</u>

It is paramount that organisations disclose their views on the impact of climate related risks on their ability to create value over time and their strategy for retaining this ability. The ability of an organisation to create value over time underpins ‘long term shareholder value creation’ and depends greatly on the extent to which the organisation’s assets (continue to) produce sufficient income. Organisations should thus ensure that the way they allocate their capital is based on a proper assessment of the likely impact of climate change on the income producing ability of different types of assets. **Such assessments of the impact of climate change on the income producing ability of assets that are considered for investment should be disclosed to investors.**

Also, organisations need to have a proper asset impairment policy. Climate change, and the related physical and transition risks, might necessitate significant impairments. European Investors feels the recommendations could elaborate more on what is expected from organisations in relation to their accounting for (potential) impairments of assets on their balance sheets and their disclosures in this regard. Overoptimistic asset valuation practices results in the disclosure of misleading information to investors, which we of course need to prevent. Also, suspicions of improper accounting, such as is the case at Exxon Mobile, need to be avoided as they can, regardless of whether they are valid or not, lower the trust of investors in capital markets.

<u>1.2 Scenario-analyses</u>

European Investors appreciates the emphasis on scenario-analyses which it believes to be the only sensible basis for disclosures that extend beyond the regular time frame for strategic and capital planning, taking into consideration the many unknown variables at play. We do however see some serious challenges with regards to the use of scenario-analyses.

Firstly, a considerable degree of standardisation in the way organisations within the same sector choose their scenario’s would be necessary. Without such standardisation, it will be difficult for investors to make meaningful comparisons between these organisations. **The TCFD could prescribe, for each sector, the three scenarios (instead of only prescribing the 2°C scenario) that should be used at a**

minimum, for example a scenario with a moderately higher temperature increase and one with a significantly higher temperature increase. **Also, standardized time horizons would be welcome.**

Secondly, not only are organisations expected to describe the potential impact of different scenarios, the recommendations also state that these scenarios may inform changes to their strategies and financial plans, risk management activities, or targets/metrics to mitigate risks and take advantage of opportunities. Decision-making on the basis of scenario's, however, would need to involve the assignment of probabilities to the different scenario's as the potential effects on the organisation under different scenario's might greatly diverge and thus require different decisions. **How should organisations assign such probabilities and what information should they provide to investors?**

1.3 Risk management

The recommendations in relation to risk management are very welcomed. Although climate related risks are of a particular nature, European Investor feels that climate-related risks should be treated in the same manner, to the maximum extent possible, as other more traditional risks that organisations face. **Organisations should apply their usual risk management processes with equal thoroughness to climate related risks.** Any differences in approach, especially when being less profound, should be highlighted and duly justified by the organisation.

A thorough approach should in our view be based on the infamous 'three levels of defence' model (operational management, risk management and internal audit) whereby the audit committee in our view should be considered a separate and powerful fourth one. We think **audit committees should be encouraged to evaluate the internal risk management processes in relation to climate-related risks and report to investors on the discussions they had with management.**

European Investors notes that the recommendations involve the concept of materiality, as was also prescribed by the G20. We support the use of this concept. At the same time, we have some concerns about the different interpretations that can be given to this concept. European Investors' view is that the concept of materiality should be based on the reasonable investor assumption, meaning that information is material (and should thus be disclosed by the organisation) if it concerns information that a reasonable investor would be likely to use as part of the basis of his/her investment decisions.

1.4 Governance

Under 'Governance', European Investors likes to see **more attention being paid to the need for organisations to ensure the required expertise** in relation to climate related risks and their financial implications is present throughout their own organisation. The board, the (operational and risk) management, and the internal audit should have easy access to such expertise.

European Investors notes that, under 'Governance', the TCFD is quite cautious on the need to have certain governance arrangements in place and to disclose these arrangements to investors. For example, in the Guidance for All Sectors, it is stated that "in describing the board's oversight of climate related issues, organisations should consider including a discussion of whether the board and/or board committees consider climate-related issues when reviewing and guiding strategy, major plans of action, risk management policies, annual budgets, and business plans as well as setting the organizations performance objectives, monitoring implementation and performance, and overseeing major capital expenditures, acquisitions, and divestitures"

We think it is absolutely **essential that boards include considerations of climate related issues in their oversight of management** (particularly in relation to strategy, including financial planning, and risk management). If the board does not do so or only to a limited extent, this should definitely be disclosed to investors, accompanied by a proper justification. The wording 'should consider including a discussion of whether' is in our view too noncommittal.

1.5 Performance/remuneration

Restricting the obligation to describe how performance and remuneration take into consideration climate related issues to one specific sector, is in our view not the best approach.

As indicated in section 1.3, European Investors' view is that climate-related risks should be managed in the same manner (i.e. with the same thoroughness) as other, more traditional risks. If the adequateness with which management manages material risks is part of the performance assessment metrics or remuneration schemes used by the organisation, which we believe to be best practice, then climate-related risks should be taken into consideration as well, regardless of the sector in which the organisation operates.

1.6 Assurance

The recommendations do not refer to assurance (or auditing) issues. With climate-related financial disclosures, the risk of including misleading information is highly probable. While investors need to be aware that forward-looking information is based on assumptions which cannot be verified by an independent auditor, **investors should be assured that information on climate-related risks does not contain material inaccuracies and there are no inconsistencies between what the organisation discloses in its management report and in its financial statements.**

Also, we think i**ndependent auditors should provide a judgment on the reasonableness of the assumptions that are made by the organisation** and that form the basis for forward looking information. A comparison with the assumptions made by peers could provide valuable information. If the independent auditor has doubts about the reasonableness of assumptions, he should consider disclosing such doubts in his audit report. European Investors would also support an obligation for organisations to issue a longer-term viability statement with a lookout period that is considerably longer than twelve months. Such statement needs to take into account the financial implications of climate-related risks and should be audited by an independent auditor.