Assessing the Risks and Opportunities of Climate Change to your Business

It is dangerous for companies to disregard the risks of climate change nowadays. Extreme weather events like heat waves and large storms, which are expected to occur more frequently and intensely due to global warming, could result in damaged assets and unanticipated financial losses.

But how can companies go about assessing the risks -- and even opportunities -- that climate change could bring to their operations?

One resource they could use is the recommendations by the Task Force on Climate-Related Financial Disclosures (TCFD), which was established by the Financial Stability Board in 2015. The TCFD recommendations are now widely used by industry players around the world to report on climate risk to businesses.

The recommendations are applicable across sectors and are designed to solicit useful, forward-looking information to include in mainstream financial filings. It is structured around four thematic areas: governance, strategy, risk management and metrics and targets, with a total of 11 recommended disclosures across the four areas.

Table A1

TCFD Recommendations and Supporting Recommended Disclosures

Governance	Strategy	Risk Management	Metrics and Targets
Disclose the company's governance around climate-related risks and opportunities.	**Disclose the actual and potential impacts of climate-related risks and opportunities on the company's businesses, strategy, and financial planning where such information is material.**	**Disclose how the company identifies, assesses, and manages climate-related risks.**	**Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.**
a) Describe the board's oversight of climate-related risks and opportunities.	a) Describe the climate-related risks and opportunities the company has identified over the short, medium, and long term.	a) Describe the company's processes for identifying and assessing climate-related risks.	a) Disclose the metrics used by the company to assess climate-related risks and opportunities in line with its strategy and risk management process.
b) Describe management's role in assessing and managing climate-related risks and opportunities.	b) Describe the impact of climate-related risks and opportunities on the company's businesses, strategy, and financial planning.	b) Describe the company's processes for managing climate-related risks.	b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.
	c) Describe the resilience of the company's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the company's overall risk management.	c) Describe the targets used by the company to manage climate-related risks and opportunities and performance against targets.

The four thematic areas and 11 recommended disclosures by the TCFD

By following the TCFD recommendations, companies can engage with investors, lenders, insurers and other stakeholders on how they are managing climate change-related risks and opportunities.

They can also evaluate the climate risks to their businesses, suppliers and competitors more effectively, make better informed decisions on capital allocation, and engage in strategic planning, says the Task Force.

While much of this form of reporting is voluntary at this time, it may become increasingly important for companies to assess climate change risks to their businesses going forward.

This is driven by demand from investors and lenders who seek for such disclosures from companies. For instance, BlackRock is a founding member of the TCFD and encourages its investee companies to report in line with the TCFD recommendations. The PRI, the world's largest investor network on sustainable investing, has also integrated climate-related indicators based on TCFD recommendations in its reporting framework since 2018.

Figure A4-1

PRI Indicators Mapped to TCFD Recommended Disclosures by Year

TCFD Recommendation	TCFD Recommended Disclosure	2018 PRI Indicator	2019 PRI Indicator	2020 PRI Indicator*
Governance	a) Describe the board's oversight of climate-related risks and opportunities.	SG 07.1a CC	SG 07.6 CC	***SG 07.6 CC***
	b) Describe management's role in assessing and managing climate-related risks and opportunities.	SG 07.1b CC	SG 07.7 CC	***SG 07.7 CC***
Strategy	a) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.	SG 14.2a CC	SG 01.6 CC	***SG 01.6 CC***
	b) Describe the impact of climate-related risks and opportunities on the organization's business, strategy, and financial planning.	SG 01.3b CC	N/A	N/A
	c) Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	SG 13.1a CC	SG 13.4 CC	***SG 13.4 CC***
Risk Management	a) Describe the organization's processes for identifying and assessing climate-related risks.	SG 14.7 CC	SG 14.8 CC	SG 14.8 CC
	b) Describe the organization's processes for managing climate-related risks.			

Examples of PRI indicators drawn from TCFD recommendations

Additionally, as more countries pursue net zero greenhouse gas emissions targets in the next few decades, governments may start demanding mandatory disclosure of climate-related financial information from companies.

According to the TCFD's 2020 Status Report, over 110 regulators and governmental entities globally support its recommendations. As at last October, over 1,500 organisations have expressed support for the TCFD, including Bursa Malaysia and the Securities Commission Malaysia. Nearly 60% of the world's 100 largest public companies support the TCFD or report in line with its recommendations.

Addressing the challenges of companies

Of course, implementing the recommendations is not without challenges. In 2019, the Task Force ran a comprehensive survey to understand the challenges companies face in doing so.

Some of the themes that emerged from the survey include the importance of educating the board and senior management on climate-related issues and gaining their support, which is crucial for implementing the recommendations.

Figure C1

Top Implementation Issues Identified

Governance	Strategy	Risk Management	Metrics and Targets
Climate is embedded in our processes so it is challenging to discuss separately in our governance disclosures. *(49%, 89)*	Disclosing scenario analysis assumptions is difficult because they include confidential business information. *(46%, 83)*	Climate is integrated into our risk management processes and, therefore, does not require separate disclosure. *(36%, 65)*	There is a lack of standardized metrics for our industry. *(42%, 75)*

Base size: 180

Percent and Number of Responses

There also appears to be a misinterpretation of the governance and risk management recommendations, with over half of the preparers believing that companies should have separate processes for governance and risk management of climate-related issues, or that the disclosure of such processes must be separate from the disclosure of their broader strategies in this area.

The Task Force clarifies that if a company's disclosure of its governance and risk management processes clearly covers climate-related issues, no further disclosure may be needed.

Under the strategy theme, companies were concerned that disclosing scenario analysis assumptions could expose confidential business information. Scenario analysis requires companies to describe the resilience of their strategies, taking into consideration different climate-related scenarios.

To this end, the Task Force encourages companies to consider a stepwise approach to disclosure. This means starting by disclosing broader, qualitative information before moving on to more specific and quantitative information over time.

Meanwhile, the lack of standardised industry metrics is a challenge for preparers in meeting the metrics and targets recommendations. This problem is especially prevalent in the financial sector.

It's an issue that the Task Force also recognises, and highlights initiatives taken by industry associations and similar organisations to support their member companies to implement the TCFD recommendations.

For instance, the World Business Council for Sustainable Development has led "preparer forums" that bring together peer companies in specific industries to discuss disclosure practices.

The state of climate-related financial disclosures

The TCFD ran an artificial intelligence-powered review of 1,701 companies' reports from 2017 to 2019 and found that reporting aligned with the TCFD's 11 recommended disclosures rose in those years.

The greatest increase in the percentage of companies disclosing relevant information was in the disclosure of processes for identifying and assessing climate-related risks, which is under the risk management theme. The smallest increase was for the disclosure of companies' climate-related risks and opportunities under the strategy theme.

Figure B9

Climate-Related Risks by Sector

Climate-sensitive sectors are those most impacted by the transition risks and physical risks of climate change. The factors that drive transition risk and physical risk are defined by the TCFD recommendations. In 2019, we assessed the relative sensitivity of sectors to these climate risk drivers to inform our risk management approach. Sector sensitivity to climate risk drivers does not mean that those risks will be realized for all clients in that sector. The impact at a client-level will depend on factors such as geography, location of assets and mitigation strategies.

Table 1: Client sectors most sensitive to transition risk

Sectors	Credit risk[9]		Climate risk drivers[10]					Examples of potential impacts for clients in these sectors may include
	$bn	% of total exposure	Technology	Policy	Markets	Legal	Reputation	
Wholesale								• Changes in demand for goods/ services • Reduced revenue • Increased operating and production costs • Asset devaluation • Difficulty accessing financing • Increased capital costs • Business model failures • Reputational damage • Legal fines or judgments
Automotive	$17.0	1.5%						
Oil & gas	$20.2	1.8%						
Industrial products	$16.6	1.5%						
Mining & metals	$6.8	0.7%						
Transportation	$14.1	1.3%						
Utilities	$32.7	3.0%						
Sub-total	**$107.4**	**9.8%**						

Table 2: Client sectors most sensitive to physical risk

Sectors	Credit risk[9]		Climate risk drivers[10]		Examples of potential impacts for clients in these sectors may include
	$bn	% of total exposure	Chronic[11]	Acute[11]	
Wholesale					• Change in asset valuation • Impaired assets, write-offs and early retirement of existing assets • Lower property values • Increased capital costs and operating costs • Reduced or disrupted production capacity • Reduced revenue from lower
Agriculture	$10.9	1.0%			
Forest products	$2.3	0.2%			
Industrial products	$16.6	1.5%			
Mining & metals	$6.8	0.6%			
Real estate & related	$74.9	6.8%			
Retail					

Examples of effective climate-related financial disclosures in the TCFD 2020 Status Report

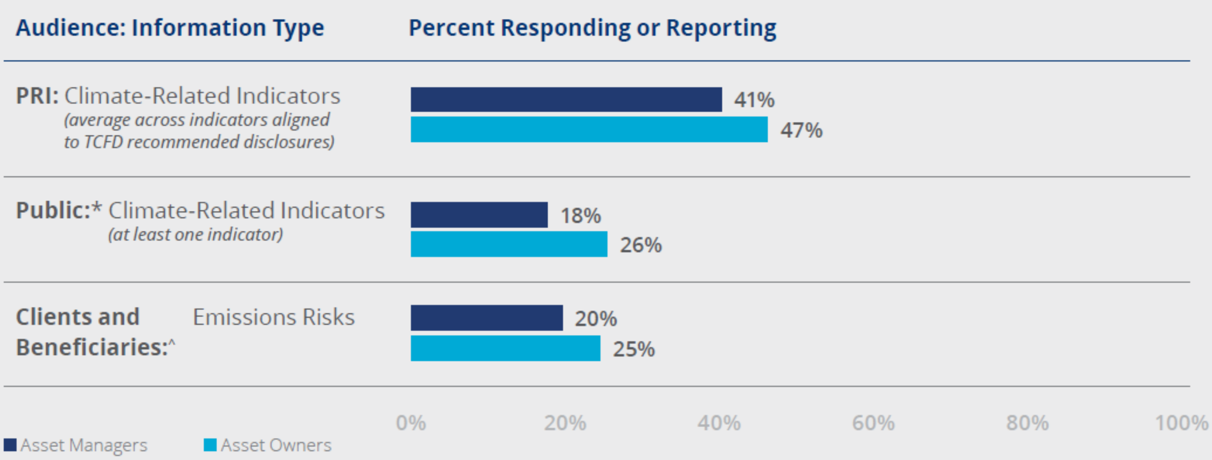
There is room for improvement. The Task Force points out that companies' disclosure of the potential financial impact of climate change on their business, strategies and financial planning remains low. The Task Force also suggests companies in certain industries to learn from the disclosure practices of other industries.

While asset managers and owners' reporting to the PRI has increased from 2019 to 2020, the Task Force believes that their reporting to clients and beneficiaries may not be sufficient.

The Task Force assessed this (*see table below)* by studying the percentage of asset managers and owners that made at least one TCFD-aligned climate-related indicator in its PRI report public, as well as the percentage of asset managers and owners that responded to the PRI that they report emissions risk information to their clients, trustees, management or beneficiaries.

Figure A12

PRI Signatories' 2020 Reporting on Climate-Related Information



* PRI, *PRI Climate Snapshot 2020*, 2020, p. 4.
^ PRI, *PRI Climate Snapshot 2020*, 2020, p. 14.

The sharing this information is important, the Task Force believes, as it has the ability to encourage better disclosures across the investment chain from asset owners and managers to the underlying companies, thus enabling better-informed investment decisions.

The Task Force recommends asset managers and owners to explore resources, such as PRI's *Implementing the Task Force on Climate-related Financial Disclosures Recommendations: A Guide for Asset Owners*, which are available on the TCFD's knowledge hub, to assist them in the process.

More information on how companies can report according to the TCFD recommendations can be found on its online knowledge hub, which also includes case studies and online courses.