Written evidence by Positive Money

Positive Money welcomes the opportunity to respond to the FCA's discussion paper on climate change and green finance

We are a research and campaigning organisation, working towards reform of the money and banking system to support a fair, democratic and sustainable economy. We are funded by trusts, foundations and small donations.

This submission will argue that:

- The FCA must work urgently with the Climate Risk Forum to establish a coherent approach to climate risk across the financial system
- Climate disclosures are currently patchy and limited, and a robust regulatory regime is necessary to improve their quality and consistency
- This must include setting a timetable for making climate risk reporting mandatory for all firms, using the framework recommended by the Taskforce on Climate Related Financial Disclosures
- The Climate Risk Forum should also cooperate to establish at least one central scenario for the effects of climate change, to which firms must refer to in their disclosures

We are interested in understanding whether greater comparability of disclosures would help investors in their decision-making more generally. If so, what framework would be most useful?

The Taskforce on Climate Related Financial Disclosures offers the most useful framework to ensure greater comparability of disclosures. In order to assess their exposure to risks stemming from climate change, investors require climate risk disclosures that are consistent, comparable, reliable, and clear.[1] Disclosures must go beyond information purely about climate-related aspects of an organisation's business. They must also include information about the financial implications of those climate-related aspects. The TCFD provides a comprehensive, internationally-recognised framework for how to do this.

Although they are not as comprehensive as the TCFD recommendations, the Companies Act and FCA Disclosure and Transparency Rules already provide a strong disclosure framework under which a significant amount of climate change-related information should already be disclosed. For example, the Companies Act 2006 already requires companies to include in their strategic report 'a description of the principal risks and uncertainties facing the company' risks, which should cover climate change risks where they are financially material. If firms are aware of such risks but still fail to disclose this information, this represents a failure of enforcement and accountability.

[1] https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf

The TCFD recommendations have certain advantages over the existing regime. In particular, the TCFD recommends that organisations should undertake scenario analysis. Scenario analysis helps firms to set strategic plans that are flexible to a range of future possibilities, and to provide the foundation for meaningful engagement with investors on an organisation's strategic resilience.

One of the objectives of the TCFD is that this scenario analysis should be comparable across firms, in order to assist investors' understanding of the systemic effects of climate risk. The most effective way to achieve maximum comparability is to establish a central scenario, or a small set of feasible scenarios, for the effects of climate change, to which financial institutions of a certain category must refer in their disclosures - either by adopting it directly, or explaining any assumptions that deviate from it.

The FCA should work within the Climate Risk Forum to establish these reference scenarios. This would help to organise disclosure around a comparable benchmark, and also affords scope to include basic estimates of systemic effects.

Would exploring a 'comply or explain' approach, or other avenues to encourage more consistent disclosures, be an effective way of facilitating more effective markets?

A 'comply or explain' approach should be adopted as a minimum, with a view to moving towards mandatory disclosure as soon as possible. The FCA should clearly outline a plan to move to a mandatory regime. Climate change results from the failure to account for the true cost of greenhouse gas emissions, and from market participants having an incomplete understanding of the risks those emissions pose. Investors require access to consistent, comparable, and comprehensive information in order to address this failure. For this reason, the 'comply or explain' requirement should not be limited to companies with premium listed equity shares. The TCFD recommendations are applicable to organisations across sectors and jurisdictions and aim to be practical for near-term adoption.[2]

In France, the adoption of a 'comply or explain' approach closely aligned with the TCFD recommendations has proved to be a powerful tool for bringing disclosure onto the agenda of financial institutions[3] (reflecting evidence on the effect of formal requirements for corporate responsibility reporting more broadly[4]). A more robust regulatory regime has been shown to improve the quality of those disclosures.[5] The French law requires all listed companies, banks and institutional investors to evaluate, report and address their exposure to long-term climate-related financial risk.[6]

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[2] https://www.fsb-tcfd.org/publications/final-recommendations-report/
[3] https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf p. 24;
[4] https://home.kpmg/content/dam/kpmg/pdf/2015/12/KPMG-survey-of-CR-reporting-2015.pdf p. 33
[5] https://www.emeraldinsight.com/doi/abs/10.1108/14720701011069722
[6] https://www.unpri.org/download?ac=1421

The timeframe of voluntary reporting is too drawn out to meet the need for financial markets to understand and take action to manage climate risks. Many organisations incorrectly perceive the implications of climate change to be long term and, therefore, not necessarily relevant to decisions made today.

It is possible to design mandatory requirements to be differentiated across firms, so that they are not onerous for smaller organisations. Indeed, the TCFD recognises that 'expectations around disclosures and climate-related scenario analysis should be proportionate to the size of the reporting entity'. In any case, disclosure by large firms should be the priority - in the financial sector, large firms might become the site for concentrated pools of climate risk, which could have systemic consequences. These concerns could merit a staggered approach, perhaps allowing smaller firms longer to adapt their reporting practices. However, any such concessions need to be extremely well-justified and awarded with caution.

Do you think that a requirement for firms to report on climate risks would be a valuable measure?

Yes, the FCA should work with the Climate Risk Forum to make TCFD reporting a mandatory requirement.

Do you have any suggestions for what information could be included in a climate risks report?

The TCFD recommendations provide a clear framework for the types of disclosures required in a risks report, including: the organisation's processes for identifying and assessing climate-related risks; processes for managing climate-related risks; and how all these processes are integrated into the organisation's overall risk management. The final report also includes supplementary guidance for particular sectors, including specific types of financial institutions.[7]

Establishing a benchmark methodology for assessing the climate risk connected to financial assets must of course involve input and cooperation from private actors. The Platform Carbon Accounting Financials, created by a group of Dutch financial institutions, offers an example of how industry can collaborate to achieve transparency and uniformity in carbon footprinting and target-setting. But regulators must not simply accept methodologies produced by the private sector without, at the very least, opening them to scrutiny by civil society groups.[8]

An ideal climate-financial regulatory regime will also require rigorous disclosure of firms' carbon footprints. Clarity over a firm's carbon footprint is a necessary ingredient for understanding the burden of transition risk for its investors. The relation between financed emissions and the risks

[7] https://www.fsb-tcfd.org/publications/final-implementing-tcfd-recommendations/
[8] https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf p. 14

these entail is an open issue; yet even in the absence of a consistent methodology, more information is better than less.[9] Moreover, being explicit about financed emissions would put more direct pressure on financial institutions to decarbonise their balance sheets and help advance the green transition. New guidelines should consider options for measuring carbon footprints and financed emissions.

Do you have any views on which regulated firms should be required to compile a climate risks report?

All regulated firms are affected by climate change and should be required to compile a climate risks report. At the most basic level, all companies will be affected by the changing patterns in energy and transport usage that climate change will necessitate. Disclosure of climate risk must ultimately be mandatory for all firms, in order to deliver the consistent and comparable information necessary for the market to allocate resources efficiently. Under the 'comply or explain' principle, if firms truly believe that they have no exposure to the likely effects of climate change, they would have to provide a sufficient, explicit explanation as to why they believe that to be the case.

It is especially important that the financial sector establishes good practice on disclosure, as it is instrumental in the allocation of credit and resources, and regulators need to know it understands these issues. By a recent assessment, financial services companies are already lagging behind non-financial companies; the share of non-financial companies reporting with a high emphasis on climate change and air quality is around double that of financial services companies.[10]

In particular, banks must improve their level of financial risk reporting. While climate developments do not affect the banking industry's core business in the same sense as that of insurance companies, banks can be vulnerable to climate risk across many different levels of their portfolios (for example, through securitised assets, credit or equity exposures to fossil fuels, or even banks' customers). Scenario analysis would greatly assist monitoring prudential risks in the banking sector, and encourage greater sustainable investment.

Worryingly, as the 2018 Prudential Regulation Authority survey showed, most banks are still some way from the necessary level of disclosure: only 10% manage climate risks comprehensively and take a long-term strategic view, while 30% of banks still only consider climate change as a corporate social responsibility issue.[11] 'Comply or explain' followed by

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[9] https://www.banktrack.org/download/carbon_footprinting_of_financed_emissions_existing_methodologies_a_review_and_recommendations/cf_financed_emissions_st30112010.pdf

[10] https://www.datamaran.com/tcfd-signatories-data-brief-download/

[11] https://www.bankofengland.co.uk/news/2018/september/transition-in-thinking-the-impact-of-climate-change-on-the-uk-banking-sector

mandatory disclosure rules, and engagement via the Climate Risk Forum, should be used to encourage banks to move rapidly.

How could regulators and industry best work together as part of the Climate Financial Risk Forum?

The members of the Forum should should act quickly to establish a coherent approach to climate risk across the financial system, clarifying firms' existing climate disclosure obligations and moving towards making TCFD reporting a mandatory requirement. In order to be an effective response to the issues that climate change presents, the pace of regulatory change must be rapid. As the special report of the IPCC confirmed last year, there are only a dozen years to avoid "long-lasting or irreversible changes" that would have a potentially catastrophic impact on health, livelihoods and human security. The longer the transition takes, the more disorderly it will be, with a diminishing chance of success.

In addition, regulators need to harness the creative power of firms and industry bodies to help fill methodological and technical gaps in implementation of the TCFD recommendations. These include how to implement scenario analysis, how risk measures vary across asset classes, and how to account for scope 3 emissions. Conversely, they must not allow those entities to set priorities or derail the agenda.

For instance, establishing a benchmark methodology for assessing the climate risk connected to financial assets must of course involve input and cooperation from private actors. On the other hand, regulators must not simply accept methodologies produced by the private sector without, at the very least, opening to scrutiny by civil society groups. Examples of multi-stakeholder consultations exist: the UNEP Finance Inquiry has worked with 16 global banks on the one hand,[12] and with the World Resources Institute and 2 Degrees Investing Initiative on the other.[13] The Climate Financial Risk Forum should seek to emulate this process of multi-stakeholder engagement, and draw explicit links between proposals tabled by private institutions and civil society organisations.

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12 http://www.unepfi.org/publications/banking-publications/navigating-a-new-climate-assessing-credit-risk-and-opportunity-in-a-changing-climate/

13 http://www.unepfi.org/publications/banking-publications/exploring-metrics-to-measure-the-climate-progress-of-banks/; see also http://www.unepfi.org/fileadmin/documents/carbon_asset_risk.pdf