PRI Principles for Responsible Investment

FSB TCFD: Phase 1 Consultation Comment Letter

29th April 2016

Mr Michael Bloomberg

Chairman, FSB TCFD

Founder, Bloomberg LP

Dear Mr Chairman

ABOUT THE PRI

The UN-supported Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI represents 1500 signatories globally with US$60 trillion in assets under management. Responsible investment is an approach to investment that explicitly acknowledges the relevance to the investors of environmental, social and governance factors, and the long-term health and stability of the market as a whole. It is driven by a growing recognition in the financial community that evaluation of ESG issues is a fundamental art of assessing portfolio value an investment performance.

SUMMARY OF PRI'S POSITION

PRI signatories are already taking action on climate change, but a stronger climate-related disclosure and data use regime is essential to enabling further investor action. Furthermore, a stronger disclosure regime will in itself act as an important climate risk mitigation tool. PRI therefore welcomes the establishment of the FSB Task Force on Climate-related Financial Disclosures and also its Phase 1 Report published on 1st April 2016. We believe that the Task Force has the potential to be a "game changer" in disclosure and management of transition risk by companies, investors and policy makers. Overall, our recommendations below emphasise that financial disclosures need to focus on safeguarding both climate stability and international financial stability.

We believe that there are three significant challenges that the Task Force needs to address:

- **Alignment of interests within the investment chain:** While much attention has focused on supply of data needed for climate-related financial disclosures, demand for such data is equally if not more important. PRI's view is that asset owners are key drivers of demand for climate-related financial disclosures, with the ability to influence better alignment of the investment chain (investment consultants, investment managers, sell-side research analysts and credit rating agencies) with the long-term interests of beneficiaries. The various roles and data use cases for financial actors should be central to the TFCD's deliberations and any proposed disclosure framework.

  We encourage the Task Force to consider how its recommendations can enable asset owners to be key drivers of demand for climate-related financial disclosures. Without this, disclosures may be made but not considered or acted on by users. Please see our answers to questions 1-3, and to 12-14, which relate to this.

- **Inadequate financial risk metrics:** Investors indicate to PRI that present metrics are inadequate for understanding carbon risk. Disclosures currently focus on emissions, intensity and the physical aspects of carbon risk. However, data provided (such as emissions data) cannot easily be translated into a financial carbon risk assessment.

  We encourage the Task Force in developing a more universally accepted high-level framework for analysing the financial implications of carbon risk that can be used by investors. Please see our answers to questions 4.-10, and to 15-17, which relate to this.

- **Lack of a top-down global framework for climate-related financial disclosures:** The last decade has seen a proliferation of local corporate reporting frameworks and standards on climate risks and opportunities, through a bottom-up approach. While this bottom-up approach has assisted in evolution of good practice disclosures, a global, top-down approach is now needed for coherence and comparability. The emitters of carbon (i.e. companies or data preparers) are global and operate in different jurisdictions. Similarly, investors (data users) are global and invest in many different jurisdictions.

  We encourage the Task Force in its efforts to develop a top-down global framework that reflects the global nature of data preparers and users, while incorporating existing approaches. Please see our answers to questions 18-22 which relate to this.

Please find further below our detailed responses to the Task Force's consultation questionnaire, in the format requested and submitted for May 1 2016.

NEXT STEPS

We understand that the Task Force on Climate-related Financial Disclosures (TCFD) will develop voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders. We welcome the Task Force's public commitment to engaging and soliciting input from a broad spectrum of stakeholders, including through consultation and public discussion.

The PRI has experience in ESG disclosure in a number of international investment markets, and has developed a wealth of practical guidance on climate change risks and opportunities, reflecting the operational experiences of signatories. PRI offers its expertise to support the FSB TCFD to ensure the outcomes of this consultation are well-implemented, reflect existing good practice and remain current.

Yours sincerely,

Fiona Reynolds

Managing Director, Principles for Responsible Investment

Cc Martin Skancke, Chair, Principles for Responsible Investment

Nathan Fabian, Director, Policy and Research, Principles for Responsible Investment

PRI Response to FSB TCFD Consultation Questionnaire

COVERAGE AND AUDIENCES

1. Which types of nonfinancial firms should any disclosure recommendations cover? List in order of importance.

PRI consider that the following types of nonfinancial firms should be covered in disclosure recommendations, based on insights from PRI signatories including challenges experienced by Montreal Carbon Pledge signatories in interpreting and using present corporate disclosures:

Resource intensive

- Energy
- Infrastructure
- Utilities
- Consumer Staples (agriculture)
- Industrials
- Materials

Non-resource intensive

- Consumer Discretionary
- Consumer Staples (non-agriculture)
- Information Technology
- Healthcare
- Telecommunication Services

2. Which types of financial firms should any disclosure recommendations cover?

PRI recommend that the following types of financial firms should be covered within disclosure recommendations:

- Asset Owners
- Asset Managers Commercial Banks
- Life insurers, reinsurers and general insurers
- Investment Banks

3. Which users in the financial sector should be considered as the target audience?

PRI consider that the following users in the financial sector need to be considered as the target audience:

- Asset Owners (including corporate pension schemes, public pension funds, insurance and endowments) (As asset allocators / active owners / investment management service users)
- Asset Managers (As portfolio managers / securities analysts)
- Investment consultants
- Sell-side analysts and research providers
- Retail investors and beneficiaries.

CLIMATE-RISK DIMENSION

4. For nonfinancial preparers of climate risk and opportunity information, what are the top three key concerns that you would like the Task Force to keep in mind in making our recommendations?

For non-financial preparers of climate risk and opportunity information, we encourage the Task Force to consider that the overall approach needs to assist in ensuring that any potential stress on the financial system from an energy transition is understood by policy makers and investors.

5. For users of climate risk and opportunity information, what are five specific points of information that you wish to secure?

PRI consider that the following points are important to securing information needed by users of climate risk and opportunity information:

Firstly, adoption of the Task Force's seven fundamental principles, identified in the Phase 1 Report published on 1st April. These principles are welcome and will assist PRI signatories in securing appropriate and meaningful information across investor types, geographic markets, asset classes and sectors.

Secondly, The Paris Agreement and parties' commitment to a long-term goal of "below two degrees" need to be considered within disclosures provided, with over 100 investors having welcomed the agreement through the Paris Pledge for Action in 2015.

Thirdly, in terms of specific information that needs to be secured by users, we encourage the Task Force to consider the strong signal on disclosure sent by investor support for the 2015 Aiming for A shareholder resolutions, with similar resolutions underway in 2016. These resolutions specifically seek to secure information from energy/mining companies in five key areas: ongoing operational emissions management; asset portfolio resilience to the International Energy Agency's (IEA's) scenarios; low-carbon energy research and development (R&D) and investment strategies; relevant strategic key performance indicators (KPIs) and executive incentives; and public policy positions relating to climate change. The resolutions highlight that users need preparers to make clear the links between transition, company strategy and climate-related risks and opportunities, where these may impact on company strategy.

Additional information points that investors are considering include break-even price ranges for a fossil fuel supply company's potential project portfolio along a supply curve; the projected product demand levels and projected price ranges used for strategic planning; potential emissions embedded in the reserves and resources in which the company has an interest and expects to generate revenues from in the future, and assumptions regarding rates of change in the costs of energy technologies used in planning cases.

Additional user need considerations include:

- Recommendations need to be tailored to specific sectors, and allow for differentiation between companies, with the voluntary nature of the disclosures providing an opportunity for flexibility in this regard.
- Preparers need to articulate clearly the links between transition, company strategy and climate-related risks and opportunities.
    - Users require quantitative, qualitative, historical and forward-looking metrics. We welcome encouragement of use of stress testing and scenario analysis.
    - Users also require consistent and comparable application of disclosure standards across the G20 and beyond, reflecting the global nature of investments.
    - For data to be of high enough quality for users, third party assurance is needed.

6. Are there any best-practice disclosures of climate risks by companies that you would like to bring to our attention? What specific climate elements of this disclosure would you like to highlight? (Please limit to two examples)

PRI understands that company best practice is still evolving, particularly in the disclosure areas in the Aiming for A shareholder resolutions. We would like to highlight the following good practice disclosures of climate risks by companies for the attention of the Task Force:

- BHP Billiton: the company outlines the impact to earnings (EBITDA) from a range of low carbon scenarios over a period of 20 years, including scenarios consistent with a 2C outcome.
- Statoil: has analysed the value-at-risk to the net present value (NPV) of its current portfolio of assets from a range of low carbon scenarios, including one consistent with a 2C outcome.

7. "Transition Risk" in terms of climate is an evolving term. How would you define this risk? What specific disclosures would help measure it?

PRI recognizes that "transition risk" in terms of climate is an evolving term. We welcome the Task Force's further consideration and definition of transition risk, and engagement with PRI signatories and other stakeholders on this term.

PRI considers that transition risk refers to the financial risks which could result from the process of adjustment towards a lower-carbon economy. Changes in policy, technology and physical risks could prompt a reassessment of the value of a large range of assets as costs and opportunities become apparent. As highlighted by Mr Mark Carney on September 2015, during his speech at Lloyds of London, "the speed at which such re-pricing occurs is uncertain and could be decisive for financial stability…Risks to financial stability will be minimized if the transition begins early and follows a predictable path, thereby helping the market anticipate the transition to a 2 degree world."

Overall, PRI encourages an orderly transition to a low carbon and climate resilient economy, in the belief that this will be more efficient and address the risk of market volatility. A strong disclosure framework will enable PRI signatories to understand the gap between the current position and a pathway of below two degrees. Disclosures that would assist in measuring transition risk would include:

- Emissions trajectories and policy disruption: the expected emissions reduction gap between the Paris Agreement pledges and delivered policy instruments – the NDCs – on an annual basis. In addition, a stronger understanding of regulated emissions and unregulated emissions risks would assist in measuring transition risk.
- Financial exposures and re-pricing: the aggregate credit exposure to fossil fuel assets and listed market fossil fuel company valuation risk tracking.

We would like to highlight the regulatory development in France of Article 173 of the Energy Transition Law. This requires institutional investors to disclose information on their general approach to ESG issues, investment policy and risk management including any relevant ESG risks identified, and an explanation for ESG criterial partially or not considered. Investors must also provide assessment of physical climate risk and transition risk (exposure to changes caused by the transition to a low carbon economy) and an assessment of the fund's contribution to meet the international target to limit climate change and the French low carbon strategy's carbon budgets.

PRI would also like to highlight De Nederlandsche Bank (2016) Tijd Voor Transitie ("Time for Transition – an exploration of the transition to a low carbon economy"), which finds that Dutch pension funds are aware of and planning to manage risks associated with climate change.

8. Which three sectors do you think most exposed to climate risks? For these sectors, how are physical, transition, and liability risks best measured and reported?

PRI consider that investors need to have processes in place to adequately identify sectors most exposed to climate risks. Further dialogue with PRI signatories is needed to understand the intersection between the energy and financial sectors, and to determine how physical, transition and liability risks are best measured and reported.

Sectors we consider most exposed to climate risks include:

- Fossil fuel exploration and production (impacting on transition risk)
- Energy generation and distribution (impacting on transition and physical risks)
- Infrastructure (impacting on physical and transition risks).

9. How should the task force consider the challenge of aggregate versus sector-specific climate-related financial risks and opportunities?

How the Task Force considers aggregate versus sector-specific climate-related financial risks and opportunities:

The main challenge we believe that investors face relates to how an aggregate global carbon budget can be translated into risks and opportunities for specific sectors and companies.

The Task Force needs to consider a framework to enable aggregation of climate-related financial risks and opportunities at the company, sector, portfolio, system and policy maker level. In the longer term, this would enable policy makers to have a clear and complete picture of transition-related risks.

PRI recognizes that this is a challenging area. In the short-term, we encourage the Task Force to focus on strong corporate disclosure as a foundation for a longer term goal of aggregate understanding of climate-related risks and opportunities.

10. Is there a role for scenario and sensitivity analysis—for the nonfinancial and/or financial sectors?

PRI considers that there is a role for scenario and sensitivity analysis for the nonfinancial and financial sectors. Methodologies need to be further developed in both these sectors. Useful work to consider includes the UK PRA's report, UNEP Inquiry research and analysis by The Carbon Tracker Initiative.

ASSET-CLASS DIMENSION

11. Which are the key asset classes that require initial attention? Are there any gaps that we should focus on? Within this, what are the top two priorities for action?

PRI recommends that the Task Force consider the following asset classes: equities, fixed income/lending, private equity/venture capital, property/real estate, infrastructure and real assets.

PRI signatories have indicated that equities, fixed income and infrastructure are the immediate priority areas for consideration of transition risk.

PRI signatories are considering climate change-related risks and opportunities within all of these asset classes (see PRI 2015 publication, *Developing a PRI Asset Owner Climate Change Strategy).*

We would also like to highlight the Environment Agency Pension Fund's "Strategy to Reduce Climate Risk" which articulates how the fund has considered the implications of climate change scenarios on strategic asset allocation to inform the development of a robust portfolio.

Mercer's 2015 publication, *Investing in a Time of Climate Change,* considers asset classes with estimates over a 35-year period to 2050.

INTERMEDIARY/USER SCOPE (investment chain)

12. Considering the breadth of services the capital supply chain provides, please provide up to three examples of leading work (research or other) from sell-side brokers' investment recommendations, listing rules of stock exchanges, portfolio management and stewardship examples by fund managers, fund-manager recommendations by consultants, or others we should consider.

Examples of leading work

The Task Force should consider The Sustainable Stock Exchanges Initiative *Model Guidance on Reporting ESG Information to Investors*, and also *Measuring Sustainability Disclosure* by Corporate Knights Capital and Aviva plc (ranking the World's Stock Exchanges in 2015).

In addition to sell-side and buy-side research on climate change by PRI signatories, we would like to highlight analysis by The Carbon Tracker Initiative. We encourage the Task Force to consider recent research by Mirova and Carbone4:
http://www.mirova.com/Content/Files/Mirova/NEWS/PR_Mirova_Carbone_4_%20EN.PDF

We also recommend that the Task Force considers recent research by PRI including:

- PRI and UNEP Finance Initiative (2015): *Fiduciary Duty in the 21st Century.*
- PRI (2016): *Beliefs to mandates: How asset owners can drive responsible investment*
- PRI (2016): *The French Energy Transition Law*

13. Please identify three examples of existing disclosure practices on climate risk and opportunities that you consider to be effective by investment banks, stock exchanges, investment managers, investment consultants, or asset owners. Please indicate the preparer and type of disclosure.

Examples of effective disclosures by financial sector preparers:

- PRI would like to highlight financial sector voluntary disclosures provided by 120 signatories to the Montreal Carbon Pledge. Preparers of these disclosures are asset owners and investment managers across the G20. http://montrealpledge.org/ and http://climateaction.unfccc.int/cooperative-initiative/montreal-carbon-pledge/all-themes
- While the Montreal Carbon Pledge focuses on disclosure of carbon footprints, best practice disclosure by such preparers goes beyond this to cover forward-looking factors, risk and climate change strategy. We would like to highlight disclosures by the Environment Agency Pension Fund, ABP, Aviva, AXA, Mirova and Old Mutual.
- In addition, we encourage the Task Force to consider independent views on investor disclosure, such as those provided by the Asset Owner Disclosure Project.

14. How can climate risk information be simply summarized for retail investors? What standards or mechanisms exist for assuring end investors that climate risks and opportunities have been considered in the way that their savings and investment and pension products have been managed?

Climate risk information for retail investors:

- We encourage further development of appropriate climate risk information for retail investors, as appropriate for different geographic markets.
- Information provided to retail investors needs to be clear and simple, allowing for understanding of emissions, risk and opportunity, including both historical and future-oriented approaches. This needs to enable a degree of comparison of products by retail investors, while allowing for products with different objectives and client types.
- We encourage the Task Force to engage in further dialogue with appropriate associations and retail investors on this to identify retail investor needs.

MACRO SCOPE (Macroeconomic analysis)

15. In conducting macroeconomic analysis, what are the top three key measures of macroeconomic climate risk performance when seeking to measure the extent to which the global economy is transitioning towards net-zero emissions?

Macroeconomic analysis and climate risk performance:

- We encourage further development of measures in macroeconomic climate risk performance. Potential indicators need to consider fossil fuel and renewable energy investment, as well as physical climate change impacts.
- Meanwhile, we encourage the Task Force to consider a recent report by The Economist Intelligence Unit, which considers value at risk from climate change: http://www.aviva.com/media/thought-leadership/climate-change-value-risk-investment-and-avivas-strategic-response/

16. One way to measure transition risk is by considering disclosures based on sector/market scenario analysis. What scenario planning work is currently available in this area?

Governments and other organisations already undertake scenario analysis, but this is less developed by companies and investors. We encourage the Task Force to develop guidance on scenarios that need to be considered, including a below two degrees scenario.

17. The United Nations Framework Convention on Climate Change five yearly “global stocktakes” seek to establish in part whether financial flows are consistent with the less-than-two-degree scenarios. Are there any climate-risk disclosure recommendations that would appropriately feed into such an effort?

The United Nations Framework Convention on Climate Change “global stocktakes”

PRI welcomes and supports strong implementation of the Paris Agreement, including the UNFCCC process for five-yearly global stock takes. We also actively support efforts by the UNFCCC and OECD to track private sector financial flows.

We consider that more transparency is needed to enable appropriate information feeds to the UNFCCC 5-yearly stock take. We encourage investors to complete the PRI Reporting Framework and the Low Carbon Investment Registry, which allow for investor reporting on investment practices on climate change and better measurement of investment flows. An important element of the Low Carbon Registry is that it provides guidance to investors on what investments are broadly consistent with transition to a less than 2 degree trajectory. The

Taskforce could encourage further attention to this area by encouraging disclosures of the financial resilience of assets in a 2 degrees or less world.

PRI is presently in dialogue with UNFCCC on how investor disclosures made through the PRI Reporting Framework could assist in five-yearly global stock takes.

LOOKING AHEAD

18. How should the Task Force define "success"?

The Task Force could consider the following in its definition of success:

- Development of a robust framework for reporting by companies that supports a transition to a low carbon and climate resilient economy, including peaking of emissions by 2020.
- Strong and coherent implementation of this framework through voluntary disclosures by companies on transition-related risks, across sectors and jurisdictions.
- Enhanced global policy action to assess and manage transition-related risks, including climate stability and international financial stability. The framework needs to support collaboration and co-ordination on transition risk by national financial authorities and international standard setters.

19. What are the key barriers that you believe the Task Force needs to overcome?

PRI considers that the Task Force will need to overcome the following key barriers:

- Investor governance, including perceptions on climate change and fiduciary duty, as well as weak incentives for consideration of transition-related risks in the investment chain.
- Weak sector-specific metrics and comparability within sectors, particularly the energy sector.
- Commercial sensitivity, which needs to be balanced with providing decision-useful information.

20. Is the Task Force focused on the appropriate set of topics for its Phase II work plan?

We believe the Task Force is focused on the appropriate set of topics in its Phase II work plan and that outreach, including substantial engagement across geographic markets and actors will be important to execution.

21. What additional topics should it consider?

22. The Task Force plans to reach out to a broad sample of key stakeholders among preparers, users, and standard setters. Are there particular types of entities or organizations that you believe the Task Force should reach out to?

Reaching out to stakeholders

The Task Force may need to consider its composition and whether additional asset owner representation is needed (e.g. pension fund representatives). See recent PRI publications on the key role of asset owners in driving responsible investment: https://www.unpri.org/download_report/6385

Types of entities and organisations the Task Force should reach out to include:

- Asset owners

- Investment managers
- Service providers
- Stock Exchanges
- Stakeholders such as NGOs including The Carbon Tracker Initiative, CDP, CDSB, SASB, as well as trade union representatives.
- Investor associations and membership bodies such as PRI, IIGCC, Ceres/INCR, IGCC and AIGCC.

CONSULTATION RESPONSE CONTACT POINT

Contact name: Sagarika Chatterjee, Associate Director, Policy and Research
sagarika.chatterjee@unpri.org

Organisation: Principles for Responsible Investment

Address: 25 Camperdown Street, London, E1 8DZ

Organisation type: Business representative organisation/trade body