

TCFD Consultation Response

July 2021

Climate Safe Lending Network

An Urgent Clarification on the Scope of TCFD

The TCFD, since its formation, has focused on the inward risks and opportunities (from the climate to business/finance) rather than the materiality of outward risks (from business/finance to the climate). Whilst the two have connection via transition risk and litigation risk, they are not identical and the residual climate impacts not covered by transition policy remain. On an aggregate basis, these impacts undermine planetary stability (via contribution to causing physical risks, whether those risks are suffered directly by the business/finance entity in question). In turn, this undermines financial stability.

The narrow framing of risks & opportunities is repeated within the consultation document:

Box A1 (highlighting added):

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| a) Disclose the metrics used by the organization to assess climate- related risks and opportunities in line with its strategy and risk management process. | b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks | c) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets. |
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By adding Transition Plans (including net-zero plans, 1.5°C alignment, etc.) in the scope of TCFD, the committee's framework extends to the concept of whether a company or financial institution is transitioning at a rate commensurate with scientifically predicted outcomes. In this context, the TCFD is moving into an ambiguous territory whereby on the one hand it is extending into the concept of climate impact (the external consequences of finances whether or not financial risks/opportunities materialise) insofar as the aggregate climate impact will drive overall planetary and financial stability.

Therefore, there is a critical choice to be made. Either:

- A. TCFD will extend its conceptual framework to include Finance-related Climate Impacts and other aspects of Sustainability Reporting ¹(thereby amending Box A1 above accordingly); or,
- B. TCFD will continue to focus on Financial Risk & Opportunity Disclosures, potentially opening up the path for a parallel Taskforce for Finance-related Climate Impacts (TCFI).

Transition Plans

Applying the choice on the purpose of TCFD (A or B above) would help to clarify some other definitions which are implicit within the document. For example, the definition provided for Transition Plan (*p.9, Proposed Guidance on Climate-related Metrics, Targets, and Transition Plans*):

- *A **transition plan** is an aspect of an organization's overall business strategy that lays out how an organization aims to minimize climate-related risks and increase opportunities as the world transitions toward a low-carbon economy, including by reducing emissions of its own balance sheet and that of its value chain.*

This assumes that the prevailing purpose of TCFD, is focused on the management of risks and opportunities (option A above) without extending the concept to climate impacts (option B above).

An overview of transition plans is given:

The commitments driving transition plans may vary between companies and may be determined in part, or in whole, by regulatory or industry requirements. These targets should specify which emission scopes are included.

- **Net-zero target.** *According to the IPCC, in order to keep warming to 1.5°C, emissions must reach “net-zero” by 2050. The “net” in net-zero means any residual emissions from hard-to-abate industries need to be removed from the atmosphere through technology or nature-based solutions.*

- **Carbon-neutral target.** *Carbon-neutral means that while some emissions are still being generated by an organization, these emissions are being offset somewhere else making the overall net emissions zero.*

¹ As per the definition in **Reporting on enterprise value** (CDP, IMP, WEF, Deloitte, 2020)

• **Zero-carbon target.** *Zero-carbon means that no carbon emissions are being produced from a product/service (e.g., zero-carbon electricity could be provided by a 100% renewable energy supplier).*

• **Paris-aligned target.** *Paris-aligned means a commitment in line with the Paris Agreement goal to hold the increase in the global average temperature to well below 2°C above pre-industrial levels and pursue efforts to limit the temperature increase to 1.5°C.*

However, this reinforces the sense that transition plans can be determined based on free choice as long as targets are contextualised. Whilst the degree of ambition may be set by a business/financial institution, the underlying building blocks (e.g. inclusion of scope of emissions etc) should be set on a consistent basis.

The principles of Transition Plans set out in Table E1 are helpful, but could be extended in the following ways:

1. **Disclosed as part of the broader organisational strategy:** to ensure strategic alignment, there should be an analysis of any tensions between organisational strategy and climate strategy (via a risk matrix).
2. **Anchored in quantitative elements, including climate-related metrics and targets:** however, where accurate data measurement is not yet available or consistent, this should not prevent strategy development or execution to reduce emissions. The Climate Safe Lending Network has engaged with more than 100 stakeholders in the banking sector (including banks, investors, NGOs, academics and regulators) and has consistently heard that accurate quantification is too frequently becoming a barrier to action.
3. **(NEW) Communicable in an understandable form for all stakeholders:**
The Transition Plan should be readily communicable to other stakeholders in a form that will be understandable (e.g. for a bank's transition plan, it should be understandable not just for the benefit of investors and regulators, but also for customers, businesses, and the wider public).
4. **(NEW) Should be compared against climate safe scenarios based upon the most recent science (e.g. IEA NZE2050):** There are many fields of research which will inform our future understanding on the science of climate change - the potential non-linearities, the absorption capacities of land and oceans etc). For this reason, Transition plans will need to be continually adjusted to reflect a comparison to the most up-to-date benchmarks. If we were to create a 'fragile' system without this dynamic renewal process of transition plans, then we are likely to see a system break (e.g. where the underlying management and disclosure frameworks make businesses and financial institutions 'path dependent' on scenarios which are no longer appropriate to apply). The strategies could become locked on course to these redundant scenarios causing a collective failure to maintain financial stability.

Principle of Full Look-through for Financial Intermediaries

Supplemental Guidelines to Banks (p.64, *Proposed Guidance on Climate-related Metrics, Targets, and Transition Plans*). The current text proposal reads:

"Banks should describe significant concentrations of credit, investment, and underwriting exposure to carbon-related assets.¹⁴ Additionally, banks should consider disclosing their climate-related risks (transition and physical) in their lending and other financial intermediary business activities."

It is a welcome clarification that banks should include investment and underwriting (e.g. off-balance sheet activity); However, limiting this to exposures does not recognise the impacts that may not crystallise as risks for the bank. Indeed, many of the off-balance sheet transactions shift the (climate) risks to others, whilst still being responsible for significant climate impacts. Again, regarding the choice of purpose for TCFD, this should either be extended, or, a gap should be filled by a complementary TFCI (see above).

Regarding 'financial intermediary business activities', this should be clarified further for the avoidance of doubt to include the concept of **full "look-through"** of any lending/investment via financial intermediaries (or nested layers of financial intermediaries) to ensure that the scope 3 of the real economy activity being financed at the end of the chain is considered in the associated climate metric.

Paris Alignment vs 1.5°C Alignment

The consultation document makes frequent reference to Paris Alignment being equated to a 2°C temperature increase. Whilst this definition can draw a line to the limit set by the Paris Agreement (although not the ambition), the use of the term 'Paris Aligned' has moved on for many stakeholders. The IPCC Special Report on Global Warming of 1.5°C has for some time become the benchmark that updates the scientific assumptions upon which the Paris Climate Agreement was negotiated, hence many now use 1.5°C and Paris-alignment interchangeably.

Moreover, it is essential that 1.5°C alignment is used as the benchmark since financial stability is seriously undermined in 2°C scenarios (including the potential non-linear impact of overshoots).

Therefore, the guidance on p.65:

"Banks should measure and disclose the alignment of their portfolios consistent with a 2°C or lower temperature pathway (e.g., Paris-aligned)."

Should be amended to, **"1.5°C temperature pathway"**.

Given the recent IEA publication of scenario NZE2050 (1.5°C aligned), it is likely that all baseline scenarios in the TCFD document should be updated to either this scenario or another credible 1.5°C scenario.

Likewise, the elements of the IEA scenario NZE2050 specifically identified certain activities as being inconsistent with 1.5°C scenarios - namely the expansion of fossil fuel infrastructure and the further exploration of fossil fuels. **The expansion/exploration of fossil fuels should therefore be explicitly identified within TCFD disclosures** both for businesses, and by extension, for all financial institutions.

Bank Financed Emissions Reporting

The inclusion of PCAF methodology as the baseline disclosure framework is welcomed as a pragmatic standard for the banking sector. (p.65)

"Banks should disclose the appropriate financed-emissions metric, based on the Partnership for Carbon Accounting Financials' (PCAF's) methodology and weighted average carbon intensity (WACI), if relevant, or a comparable methodology, for their industry where data are available or can be reasonably estimated. If a comparable methodology is used, the TCFD recommends the details of such methodology be made publicly available. See Table 3A for financed-emissions metrics."

"In addition, banks should consider providing other carbon-foot printing and exposure metrics they believe are useful for decision-making along with a description of the methodology used. See Table 3C for other suggested common carbon foot printing and exposure metrics, including weighted average carbon intensity."

For WACI and additional/alternative methodologies (including PCAF when applicable to high-carbon sectors), the bank scope-3 emission should be extended beyond client scope-1&2 and should include client scope-3. For example, in the case of oil & gas production, it would be important to include the downstream value chain (use of the fuel), rather than just the energy consumed in extraction. This has been reflected in the text of the Net Zero Banking Alliance in GFANZ:

"GHG emissions here refer to banks' Scope 1, 2 and 3 emissions. Banks' Scope 3 emissions should include their clients' Scope 1 and 2 and Scope 3 emissions, where significant, and where data allow."

This will require company disclosure of Scope 3 emissions - especially in high-carbon sectors. From this perspective the guidance example in figure D3 (p45):

Our firm commits to reducing net scope 1 and 2 emissions – as defined by the GHG Protocol – to zero by 2050, with an interim target to cut scope 1 and 2 emissions by 50% relative to a 2015 baseline by 2030. We are working with suppliers to reduce scope 3 emissions

This is insufficient since it does not include Scope 3, and only recognises upstream (supplier) emissions as part of the Scope 3 calculation.