Mastering TCFD will pay dividends in 2023's regulatory landscape

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As regulators around the world ramp up climate-related disclosure requirements, much work is needed to ensure information is useful to investors, writes **Laura Zizzo**

In the US, the SEC is consulting on its proposals to require listed companies to provide emissions and climate risk disclosures, the European Council has just approved the Corporate Sustainability Reporting Directive (CSRD), and the UK has published new guidelines for 'gold standard' corporate transition plans.

Laura Zizzo

Fortunately, amongst this plethora of emerging regulatory requirements a common thread can be identified: the Task Force on Climate-related Financial Disclosures (TCFD) framework. Launched in 2015, this veteran of climate risk and opportunity disclosure sets out four pillars for companies to provide information on – Governance, Strategy, Risk Management and Metrics and Targets.

With the TCFD's approach being integrated into developing regulatory requirements around the globe, the good news is that companies with high levels of TCFD competence and transparency are well positioned as voluntary disclosures evolve into regulatory requirements. More importantly it provides investors, lenders and insurers to those companies with greater transparency on climate data to accurately price financial risks and opportunities related to climate change.

While TCFD adoption continues to grow, Manifest Climate's comprehensive Disclosure Benchmark Review reveals that only half of TCFD disclosures in even the most advanced sectors have the clarity, specificity and comparability to make them 'decision useful' for investors and other stakeholders.

This means investors are making capital allocation decisions with incomplete information, potentially putting client capital at risk. For companies it means taking strategic and operational decisions without the full picture on climate-related risks and opportunities, meaning capital investment could be mis-aligned with emerging physical and transition risks.

Our research into a sample of financial institutions' disclosures, a sector with relatively mature TCFD reporting, showed that on average only 50% of disclosures were decision-useful, ranging from 62% decision usefulness for Strategy disclosures, to 41% for Metrics and Targets.

How do we improve decision-usefulness as disclosures shift from voluntary to regulatory requirements in 2023 and beyond? Based on our analysis of thousands of climate disclosures around the globe, some of the following approaches stand out as best practice.

Firstly, don't treat TCFD as a box-ticking disclosure exercise. Instead unleash its potential as a strategic planning framework to stress-test any company's business model and strategy against emerging climate risk and opportunity.

For example, to deliver decision-useful information related to the Strategy pillar it's insufficient to use a standard risk register approach, particularly when testing the business' resilience against different warming scenarios. Instead, a bespoke team, including experts from operations and finance, needs to consider how different warming scenarios will impact revenues, expenditure, assets and liabilities, and what strategic decisions will mitigate risk or capitalise on opportunities.

Under the Governance pillar the decision-useful information comes from looking beyond standard Governance structures and processes. Outlining the members of board committees with oversight of climate risk is a minimum requirement; the real utility only comes when detail on the cadence of meetings, reporting lines and how management is held to account (ideally through financial incentives) is also provided.

Our data shows that decision-useful disclosures on Governance are a proxy for high-performing companies when it comes to managing the risks and opportunities of climate change. This strong Governance is the key to holding the board and executive team to account to deliver a strategy that meaningfully considers climate change risks and opportunities.

Using TCFD as a common thread that can improve resilience in the face of climate risk takes effort. Companies working to deliver decision-useful disclosures based on sound sustainability plans need to be ready for some ambiguity, uncertainty and even frustration internally. But I encourage companies to embrace this uncertainty, because working through it creates the accountability and transparency around climate-related information that helps us all understand, manage and communicate financial risk related to climate.

The good news is that investment in creating decision useful TCFD disclosures will pay back across regulatory requirements in multiple jurisdictions. It will also create greater certainty for investors and other stakeholders when judging climate risk, therefore strengthening the trust between companies and shareholders which is crucial for ongoing economic sustainability and financial success.

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