9 November 2015

Proposal for a disclosure task force on climate-related risks

On 24 September, the FSB held a public-private sector meeting on the financial stability implications of climate change related issues, responding to the April request by the G20 Finance Ministers and Central Bank Governors.[1]

Following the workshop, the FSB is proposing to G20 Leaders that the FSB prompt the setting up of an industry-led disclosure task force (modelled on the successful example of the FSB's Enhanced Disclosure Task Force) to develop voluntary, consistent climate-related disclosures of the sort that would be useful to lenders, insurers, investors and other stakeholders in understanding material risks.

This note sets out the proposal and its motivation in more detail.

Possible risks

The 24 September public-private sector meeting provided an opportunity to exchange views on the existing work of the private financial sector, authorities and standard setters on the financial stability implications of climate- related issues, the challenges they face, areas for possible further work and any role that the FSB or others can play in taking that work forward.

Policymakers have an interest in ensuring that the financial system is resilient to all forms of risk. Possible climate-related risks fall into three broad categories:

- **Physical risks:** the impacts on insurance liabilities and the value of financial assets that may arise from climate- and weather-related events, such as floods and storms that damage property or disrupt trade. In the financial sector, these losses have consequences most immediately for the insurance sector, but also extend more widely;
- **Liability risks:** the impacts that could arise if parties who have suffered loss or damage from the effects of climate change seek compensation from those they hold responsible. Such claims could come decades in the future, creating liabilities for carbon extractors and emitters and their insurers;
- **Transition risks:** 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

[1] See April 2015 G20 Communique: available at https://g20.org/wp-content/uploads/2015/04/April-G20-FMCBG-Communique-Final.pdf

opportunities become apparent. The abruptness with which such re-pricing occurs could influence financial stability.

These potential risks to the financial sector from climate change are complex, and the understanding of them is still at an early stage. Risk management is currently most active and sophisticated in the general insurance and reinsurance sectors where catastrophe risk modelling and capital standards take climate risks into account.

The potential role of disclosure

The discussions at the meeting on 24 September frequently returned to the need for better information in order to improve understanding and analysis of risks, and over time, to promote a smooth rather than an abrupt transition towards a lower-carbon economy. Participants noted that improved disclosure by companies can help to provide that information base.

Appropriate disclosure is a prerequisite for both the private sector and authorities to understand and measure the potential effects on the financial sector of climate change, as markets evolve and as the wider economy transitions towards a low-carbon economy.

For instance, one relevant company disclosure could be information on the size of its carbon footprint, and its strategies to manage its transition to a lower-carbon business model. This may assist market participants in making investment, credit, or insurance underwriting decisions that take into account the physical, liability and transition risks associated with climate change, including how those risks may evolve in the future.

Using climate-related risk disclosures, financial institutions and other relevant stakeholders could then assess the credibility of firms' transition plans and their ability to execute them, and analyse the potential changes in value of their assets and liabilities that could result from a transition to a lower carbon economy or to other climate-related events (e.g. physical or legal risks). This would allow stakeholders not only to manage and price these risks accordingly but also, if they wish, to take lending or investment decisions based on their view of transition scenarios.

Financial institutions also could be encouraged to disclose their exposures to climate risks and management of those exposures. Such disclosures by financial institutions would foster an early assessment of these risks, facilitate market discipline and encourage firms to manage what they are measuring. It would also provide a source of data that can be analysed at a systemic level, to facilitate authorities' assessments of the materiality of any risks posed by climate change to the financial sector, and the channels through which this is most likely to be transmitted.

Existing initiatives

Much good work has been done in recent years to strengthen disclosures on climate-related issues. However, it has been estimated that there are almost 400 information disclosure schemes relating to climate or sustainability in existence, which approach climate-related disclosure from a variety of different perspectives and may be intended for different stakeholders. These range from industry or NGO initiatives to set out guidance, through national laws or government-led schemes, to principles set out by international organisations.

The scope of the disclosures that are encouraged or required also varies – from narrow greenhouse gas emissions disclosure through to requirements to consider material risks and opportunities from climate change, business strategies, or mitigation and divestment actions. Many of these schemes focus on a broader set of environmental, social and governance issues rather than specifically on climate-related data.

Characteristics of effective disclosures

The wide range of existing schemes relating to climate or sustainability highlights the lack of consensus at this point about what effective disclosures in this area would consist of, and the need for companies and relevant stakeholders to agree on the characteristics of examples of good practices in meeting those effective disclosures.

Experience suggests that in general effective disclosures (whether or not climate-related) should be:

- **Consistent** - in scope and objective across the relevant industries and sectors;
- **Comparable** - to allow investors to assess peers and aggregate risks;
- **Reliable** - to ensure users can trust data;
- **Clear** - presented in a way that makes complex information understandable; and
- **Efficient** - minimising costs and burdens while maximising benefits.

This is not intended to be an exhaustive list of the characteristics of effective disclosures. Nevertheless, an exercise to develop effective climate-related disclosures that satisfy the needs of lenders, insurers, investors and other interested stakeholders could take account of these characteristics. The task force's work should be informed by the international principles developed by standard setters, including IOSCO's high level principles and the G20/OECD principles of corporate governance. The task force should also consider the work of other groups related to effective disclosures.

Proposed way forward

The FSB's role in facilitating the establishment of the Enhanced Disclosures Task Force (EDTF) is a useful precedent.[2] The EDTF is comprised of private sector representatives of the users, preparers and auditors of bank financial reports. It was formed to identify and meet the needs of users of bank financial reports for improved bank risk disclosures in a variety of areas including risk governance and management; capital adequacy; liquidity and funding; and market, credit and other risks. Founded in May 2012 with the encouragement of the FSB, it developed by October 2012 a framework of disclosure principles, specific recommendations and examples of leading practices. It agreed its report to the FSB remarkably quickly, in part because there was already a clear commonality of views among all stakeholders both on the scope of the issues to be addressed and on the solutions. The growing implementation by major banks of the EDTF's recommendations has further demonstrated the effectiveness of this industry-led approach.

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[2] See http://www.financialstabilityboard.org/what-we-do/policy-development/additional-policy-areas/improving-risk-disclosures/ for fuller background on the establishment and work of the EDTF.

This precedent could be used as a model for an industry-led disclosure task force to focus on climate-related risks. The task force would aim to identify the needs of interested stakeholders for disclosures on climate-related risks and the types of companies that should make the disclosures. Effective climate-related disclosures by companies could promote more informed investment, credit, and insurance underwriting decisions about those companies. In turn, it would enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector and the financial system's exposures to climate-related risks.

The disclosure task force should not add to the already well developed body of existing disclosure schemes. Instead it should develop a coordinated assessment of what constitutes efficient and effective disclosure for financial markets and for other stakeholders, drawing on the experience both of the implementation of existing initiatives and of lenders, insurers, investors and other stakeholders. In the same way as for the EDTF, this could include a set of disclosure principles, supported by detailed recommendations and examples of leading practices drawn from current annual reports and from company disclosures and informed by users' expectations.

However, the task of the disclosure task force would be more challenging than that faced by the EDTF, because it would not start from the same degree of consensus about the types of risk most relevant to stakeholders or the firms that should make the disclosures, and because the factors that may be relevant to materiality may vary across firms and industries. So the disclosure task force would need to spend more time defining the nature of climate risks and the scope of the firms that the work of the task force should aim to cover before moving on to identifying effective disclosures. The following is a set of deliverables that could be asked of the task force:

- A stock-take of existing climate-related disclosures (including regulatory standards and guidelines, as well as voluntary initiatives), and the challenges that firms face in applying existing schemes.
- Understand and set out the needs of users of climate-related disclosures (these may include insurers, lenders, intermediaries such as credit rating agencies and equity analysts who need to analyse and provide information on assets, the buy-side who need to disclose their climate exposures, and ultimately end-customers of the buy-side, as well as public authorities).
- Identify gaps in disclosures that are currently provided and the types of entities that could provide them and challenges to achieving better consistency, comparability, reliability, clarity and efficiency of the information provided.
- If the task force sees a case for enhanced internationally consistent disclosures, develop common disclosure principles or recommendations that all relevant companies, including relevant financial institutions) would be encouraged to follow.

In doing this work, the disclosure task force should make use of existing work by international bodies and others, and consult with those bodies where appropriate.

Any disclosure recommendations by the task force would be voluntary, would need to incorporate the principle of materiality and would need to weigh the balance of costs and benefits.

The work and recommendations of the task force would help firms to understand what financial markets want from disclosure in order to respond to climate change risks, and encourage firms to align their disclosures with investors' needs.

Options for scope and objectives

In forming the more detailed terms of reference for the disclosure task force, the task force should address the following questions about the scope and objectives of its work:

- Which types of firms should recommendations cover? Which types of non-financial corporates? Which types of financial firms?
- Which users should be considered as the target audience? Should it be extended beyond lenders, investors and insurers to other users of corporate disclosures (e.g. a wider set of stakeholders which monitor climate issues)?
- Should the group take into account the potential importance of being able to aggregate or otherwise analyse information for financial stability purposes? If so, what does this imply for the recommended level of consistency of disclosures?
- Should the task force seek input from the official sector during its work (for instance through workshops or other outreach)?
- What are the key characteristics of effective disclosures for climate-related risks that any recommendations should seek to meet?
- Should the work be focused on carbon emissions, or instead seek to capture other types of climate-related exposures (e.g. including physical or legal exposures)?
- Should the disclosure task force seek to go beyond disclosures of quantitative measures of existing exposures, to more qualitative and forward-looking disclosures of plans to manage risks?

Given these challenges to be addressed, the task force's work could be arranged in two stages (with each stage potentially having a different composition of members), first to make proposals on the scope and high-level objectives of the work of the task force and then, second, if appropriate, to develop the recommendations themselves for voluntary disclosure principles and leading practices. The task force should be internationally diverse, so as to reflect the experiences of providers and users of disclosures across the range of the FSB's membership, and would be strongly encouraged to conduct public consultation and outreach at each of these stages.

The overall period of time for the work could therefore be a year or more, rather than the 5 months in which the EDTF developed its recommendations. The EDTF was co-chaired by three highly-regarded financial risk management, analysis and disclosure experts and composed of technical specialists in disclosure issues – the industry-led disclosure task force would need a mixture of financial risk disclosure and climate exposure specialists.