Green reporting will expose risky companies

By Sharon Snell

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The G20 task force has issued the new Climate-Related Financial Disclosure Framework, which will allow investors to identify and reward organisations with good climate change risk management strategies. The increased transparency requirement for reporting will benefit investors who have previously struggled to get consistent information before investing.

The global financial meltdown of 2008 has fuelled demand for transparent and meaningful financial information about climate-related risks and opportunities that companies face. The G20 Task Force has developed a new framework for companies to make these disclosures and the framework has received wide spread support from over 100 CEOs of global companies.

The World Economic Forum in a report published entitled *Global Risk Landscape 2016* has identified failure of climate-change mitigation and adaptation as the number one global risk in terms of impact. Allianz, Swiss Re Ltd, Aviva plc and AXA Group are some of the large insurers that have endorsed the framework.

David Cole, group chief executive of Swiss Re said in his statement of support: “We are just at the beginning of the transition towards a low carbon economy. As a reinsurer that has been researching the effects of climate change for almost 30 years, as a large asset owner and as a long-term investor, we have the chance to step up to the next level and help shape tomorrow’s solutions. There are clear benefits of having more transparency about climate related risks and opportunities.”

What is a stranded asset?

All companies have assets which they own and often the value of the asset is subjectively determined based on what the company believes the value of the asset to be. Mining companies as an example will place a value on their reserves, and this is reflected as an asset on their balance sheet.

Stranded assets are assets that are worth far less on market value than in book value as a result of them not performing or becoming obsolete. The resultant loss in value will have to be recorded on the balance sheet which results in a devastating loss for investors.

Companies are often slow to write down the value of assets despite having information of market changes. They hold on to inflated values, foolishly waiting for market conditions to change to the detriment of investors who do not have access to information which should have been publicly disclosed.

Three key climate risks for insurers and reinsurers

In the recent past, there has been growing calls for insurers to divest from underwriting fossil fuel projects and increase their investment in clean energy technologies. A global conference for insurers that took place in June in San Francisco was disrupted by climate activist calling for insurers to unfriend coal. The view is that if insurers can be pressured to divest, new fossil fuel projects would not be able to get off the ground without their risks being underwritten.

Insurers and reinsurers also have a self-interest in reducing the effects of climate change. In their White Paper *Climate Change Risk And The Private Sector: Adaptation & Management*, the authors have identified three key climate risks:

- ### Physical risk

  These are first-order risks that arise from weather-related events, such as floods and storms which result in damage to property, disruption of global supply chains or resource scarcity.
- ### Transition risk

  This is the financial risk that arises as behaviour, consumption patterns and societal expectations change as society transitions to a lower carbon economy. This risk factor incorporates such things as potential re-pricing of carbon-intensive financial assets, consumer preference for climate friendly practice, governmental policies, binding and non-binding agreements and regulatory mechanisms (e.g. carbon-pricing).
- ### Legal risk

  This is a litigation risk that arises when parties use the courts to hold organisations liable for loss or damage that they have suffered because of climate change. The plaintiffs could sue the company and/ or the directors and officers of the company who are responsible for governance. Liability insurance especially directors and officers (D&O) liability insurance must be reviewed in line with the insured company’s practices of climate change risk management.

G20 Task Force tackles the need for a single framework

There are several hundred climate-related disclosure frameworks which have been put in place by various companies, creating a minefield for investors to navigate and compare best practises effectively.

The Financial Stability Board identified the need for better information to support informed investment, lending, and insurance underwriting decisions and improve understanding and analysis of climate-related risks and opportunities. This information will help investors engage with companies on the resilience of their strategies and capital spending, which should help promote a smooth rather than an abrupt transition to a lower-carbon economy.

Many companies incorrectly perceive that the implications of climate change are long term and consequently not relevant to the decisions made today. At a cost of $1trn of investments per annum, most economic sectors and industries will be affected by climate-related risks and the transition to a lower-carbon economy. This transition to a lower-carbon economy present significant risk and opportunities for companies including those that provide services and products in climate change mitigation and adaptation solutions.

The task force members were drawn from various organisations, including large banks, insurance companies, asset managers, pension funds, large non-financial companies, accounting and consulting firms, and credit rating agencies. It was mandated to develop voluntary, consistent climate-related financial disclosures that would be useful to investors, lenders, and insurance underwriters in understanding material risks. And its recommendations apply to financial-sector organisations, including banks, insurance companies, asset managers, and asset owners and cover:

- Organisations with public debt or equity: widespread disclosure by these organisations is necessary to promote more informed investing, lending, and insurance underwriting decisions.
- Asset managers and asset owners (including public- and private-sector pension plans, endowments, and foundations): implementation by asset managers and asset owners would help support their clients and beneficiaries in better understanding the performance of their assets, considering the risks of their investments, and making more informed investment choices.

Disclosure in mainstream financial filings

The task force recommends that organisations provide climate-related financial disclosures in their mainstream (public) annual financial filings. It does not specify where in financial filings information should be disclosed as it will depend on the type of information being disclosed as well as national disclosure requirements or standards on how financial filings are structured. Asset managers and asset owners should use their existing means of financial reporting to their clients and beneficiaries where relevant and feasible.

Core elements of climate-related financial disclosures

The task force structured its recommendations around four thematic areas that represent core elements of how organisations operate: governance, strategy, risk management, and metrics and targets. The four overarching recommendations are supported by recommended disclosures that build out the framework with information that will help investors and others understand how reporting organisations assess climate-related risks and opportunities.

One of the key recommended disclosures focuses on the resilience of an organisation’s strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.

An organisation’s disclosure of how its strategies might change to address potential climate-related risks and opportunities is a key step to better understand the potential implications of climate change on the organisation.

The task force recognises the use of scenarios in assessing climate-related issues and their potential financial implications is relatively recent and practices will evolve over time, but believes such analysis is important for improving the disclosure of decision-useful, climate-related financial information.

In December 2015, nearly 200 governments agreed to work towards “holding the increase in the global average temperature to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels,” referred to as the Paris Agreement. This target has been included in the framework.

ABOUT SHARON SNELL

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