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Ethical Business

FT: Financial Groups in the Front against Climate Change

Policymakers essentially leverage the sector to help push for action

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Climate change may be the only policy area capable of snatching Britons' attention from Brexit. This month the UK Committee on Climate Change recommended a net-zero emissions target by 2050 and parliament declared a climate emergency. In April, the protest group Extinction Rebellion caused widespread disruption in London and 16-year-old Swedish activist Greta Thunberg met British politicians.

These signals are like the tip of an iceberg: they are the obvious signs of the shift that began among financial policymakers several years ago, driven by the Paris Climate Agreement of 2016.

The international Financial Stability Board was established by the G20 after its London summit in 2009. In 2015 it tasked Mark Carney and Michael Bloomberg, the Bank of England governor and former New York mayor respectively, to lead the Task Force on Climate-related Financial Disclosures.

The cross-sector TCFD has since developed a standard for voluntary disclosures to help businesses align their climate change statements relating to governance, strategy (including scenario analysis), risk management and metrics. As the move towards a lower carbon economy gains pace, policymakers and investors are using the TCFD as the basis for making changes to disclosure requirements

We can see more climate-related litigation globally, particularly in the US. Shareholder activism is also growing: institutional investors led by the Church of Englandare encouraging energy and energy-intensive companies to increase their ambition over tackling climate change. In Australia, lawyers are debating the ambit of fiduciary duty after the publication of a lawyer's opinion which argues that climate has to be considered in relevant business decisions, a debate likely to spread to other countries.

Regulatory changes in the EU and UK, which come into force in the next 18 months, will nudge large corporates, asset owners, institutional investors and asset managers to explain publicly how the financial risk of climate change is treated in their business strategy.

In the UK, the Prudential Regulation Authority published a supervisory statement in April. Separately, the Department of Work and Pensions issued regulations requiring pension funds to articulate their approach to material financial risk, which now includes environmental, social and governance risks, in their investment principles.

We await the outcome of an FCA consultation held last autumn. which focuses on how issuers of listed securities meet disclosure obligations on climate change risks. Assuming this is in line with the PRA approach, it is likely to encourage greater disclosure on a comply-or-explain basis.

Policymakers are essentially leveraging the financial sector to push general change. This is likely to be a challenging period for some corporates as they engage with changing expectations under the scrutiny of activist investors and the third sector.

The EU has also embedded sustainability risk management into financial regulation, requiring banks and insurers to bring climate risk into the senior manager regime and to integrate these risks into strategy, risk management and disclosure, and has political agreement on two of the

three regulations in its sustainable finance package. Sustainability benchmarks will be regulated, regulated companies will have to disclose how sustainability risks are integrated into risk management and they must also set disclosure requirements for sustainable investments.

In work to finalise the outstanding regulation, a technical group is developing a taxonomy of sustainability criteria. Separately, the European Commission is consulting on non-binding guidance on climate disclosures by large companies, which draws heavily from the TCFD.

This combined activity is bringing greater scrutiny to the climate-related implications of corporate and financial decision-making and subsequent climate disclosures. The current quality and amount of publicly available corporate information on emissions and climate change is variable and basic.

Some organisations still see sustainability as more relevant to reputation than as a financial risk issue to be part of commercial decision-making. The number of people with the necessary skills to support a more sophisticated approach is small. And yet the essence of a voluntary standard is that it is general and aspirational.

Given clear direction, the banks and corporations will respond, embedding climate and other non-traditional ESG financial risks into their decision-making and disclosure.

The change required should not be underestimated. It will be like moving from the sack race in a school sports day to running a marathon: conceptually possible but requiring hard work over several years and all in relation to a topic where knowledge and expectation continue to evolve rapidly.

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