TCFD implementation: the shifting landscape of climate change policy in North America

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Over the last five years, there has been significant consolidation of climate change standards and reporting frameworks. In particular, the framework developed by the Task Force on Climate-related Financial Disclosure (TCFD) has gained acceptance as the predominantly accepted global framework. The TCFD was established in 2015 at the direction of the Financial Stability Board to develop climate-related disclosures to promote more informed investment, credit and insurance underwriting decisions. Chaired by Michael Bloomberg and made up of 32 members, the TCFD published its recommendations (the TCFD Recommendations) in 2017. With the TCFD Recommendations receiving endorsements from several different countries and being referenced by governments, private sector entities, and securities regulators in North America, we expect the that the TCFD Recommendations will play a notable role in the future development of climate change policies in North America.

Overview

In January 2021, *The Global Risks Report 2021*, published by the World Economic Forum and based on survey results from over 650 members of the World Economic Forum's leadership team, listed extreme weather, climate action failure, and human environmental damage as the most likely global risks to occur over the next 10 years. In the midst of the COVID-19 pandemic, respondents also indicated that climate action failure was the most concerning risk to the world and a close second to infectious diseases in terms of expected impact over the next 10 years.

The physical effects of climate change are impossible to ignore and impacting businesses worldwide. The International Panel on Climate Change (IPCC) released its sixth assessment regarding the climate crisis in July of this year and described the findings as 'code red for humanity.' According to the IPCC report, with greenhouse gas emissions (GHG) continuing to rise, it is unlikely that the average global temperature rise will be limited to 1.5C, and it is possible that 2C warming will be surpassed prior to 2050. In a 2C warming scenario, among extreme weather events, droughts and fires, up to five billion people could lack a source of fresh water by 2050. By 2030, estimates by the National Oceanic and Atmospheric Administration predict more than 90 per cent of the world's reefs will be threatened by warming ocean temperatures and acidification (both directly caused by climate change) and local pressures. Coral reefs support more than 275 million people worldwide, protect coastlines in more than 100 countries and account for 15 per cent of gross domestic product in more than 20 countries. Present day losses continue to mount. For example, a report from Re-insurer Munich-Re attributed losses due to extreme weather events caused by climate change at over $210 billion dollars in 2020 alone. This number excludes lost profits, costs associated with supply chain issues and failure to get product to market. As world leaders gather for COP-26 in Glasgow in early November, there is increasing pressure for governments and the private and public sectors to act decisively and quickly to reign in GHG emissions.

Government Action

Canada, the United States, and 191 other countries are signatories to the Paris Agreement. Under the legally binding Paris Agreement, signatories commit to keeping the increase in global average temperature to 1.5C above pre-industrial levels. As part of the agreement, signatories also provide their Nationally Determined Contributions (NDC). Measured in metric tonnes of CO2e (carbon dioxide equivalent, the globally accepted metric to measure GHG emissions), the NDCs represent the amount of emissions reductions a country intends to make by 2050. With the United States' renewed commitment to the Paris Agreement following President Joe Biden's election, Canada has updated its NDC to reduce its national emissions by 40-45 per cent from a 2005 baseline, the equivalent of 403 MT CO2e. Canada's GHG emissions were 730 MT CO2e in 2019, which is exactly what they were in 2005, representing a zero per cent reduction over 14 years; however, the good news is that the economy continued to grow during that time, indicating a reduction in carbon intensity over the same period. The story is much the same across the globe. According to the World Meteorological Organization and the International Energy Agency, developed nations will need to cut their emissions by 50 per cent by 2030 – eight years from now – in order to stay below 2C warming. It is likely that following COP 26, governments will make further commitments to reduce GHG emissions. Governments are expected to pump billions of dollars into the energy transition over the next decade, but also to impose tougher regulations and higher carbon taxes. This will impact the business landscape overall, representing risk and opportunity for all sectors.

Private sector

Not willing to wait for government, the private sector is also taking action to lower emissions and assess and disclose climate-related risks. Creditors and investors are the main driver, particularly institutional investors with medium to long-term investment horizons; however, retail investors are also having a big impact on companies with respect to climate change. Shareholder activism, and indeed climate litigation, are both on the rise and investors of all types are demanding increased transparency not only of a company's carbon footprint, but also of climate-related risks generally.

Although some firms have been voluntarily reporting climate risks and/or GHG emissions since the early 2000s when the first reporting standards were published, until the recent TCFD adoption by many companies, there has been no mandatory requirement and no one global standard or framework that would allow for comparative analysis between different firms. A recent report found that as of April 20, 2021, 23 per cent of constituents on the S&P/TSX Composite Index were currently reporting in alignment with the TCFD Recommendations and a further 14 per cent of issuers expressed a desire to do so.

The world moves towards TCFD implementation (but will the United States and Canada?)

Initially targeted at the financial sector and certain key non-financial sectors, the TCFD Recommendations have since been applied across all sectors of the economy. The financial sector includes banks, asset managers, insurers and asset owners. The non-financial sectors includes firms operating in a sector that face particularly high climate-related risks:

1. energy;
2. transportation;
3. agriculture, food & forest products; and
4. buildings & materials.

Although the TCFD Recommendations are drafted as voluntary, we are seeing mandatory alignment as well as an increasing expectancy from the market that companies will rely on the TCFD Recommendations to report on climate risk and opportunity. Regarding recent uptake, the TCFD recently released its 2021 Status Report (the Status Report). The Status Report provides a detailed summary of the global momentum behind TCFD and the TCFD Recommendations. According to the Status Report, "as of October 6, 2021, the Task Force had over 2,600 supporters globally, including 1,069 financial institutions, responsible for assets of $194 trillion." In 2021, the TCFD Recommendations were endorsed by the G7, the G20 and European Commission Corporate Sustainability Reporting Directive. Several jurisdictions including the United Kingdom and New Zealand have taken steps towards mandatory reporting aligned with the TCFD Recommendations. A host of other jurisdictions and countries have announced plans to do so, including Hong Kong, Brazil and Switzerland. The Bank of England published its climate-related financial disclosure in June 2021 in alignment with the TCFD Recommendations. The report sets out the bank's approach to managing the risks from climate change across its entire operations. Blackrock, one of the world's largest asset managers with over $9 trillion under management, published its first TCFD-aligned report on climate risks in December 2020. Global climate standard setting organizations such as The alliance (previously known as the Group of Five), the International Financial Reporting Standards Foundation (IFRS) and the International Organization of Securities Commissions have also signaled their support for TCFD-aligned disclosure.

Canada

In Canada, the federal government committed to engage with provinces and territories "with the objective of making climate disclosures consistent with the TCFD disclosures, part of regular disclosure practices for a broad spectrum of the Canadian economy". The federal government has also committed to requiring all Crown corporations to adopt the TCFD Recommendations. Crown corporations holding more than $1 billion in assets must begin this reporting as of 2022. The Bank of Canada, along with many other central banks, committed to align its future disclosures with the TCFD

Recommendations. As outlined below, regulators have also indicated that future reporting requirements may also mandate TCFD-aligned climate risk disclosure.

Securities regulators in Canada are also considering how to best regulate climate change related disclosure and have taken note of the TCFD Recommendations for that purpose. On October 18, 2021, the CSA published for comment proposed climate-related disclosure requirements, which are largely consistent with TCFD Recommendations. The proposed National Instrument 51-107 – Disclosure of Climate-related Matters (the Proposed Instrument) would, subject to limited exceptions, apply to all reporting issuers other than investments funds and would require disclosure related to board oversight of climate-related risks and opportunities, material climate-related risks and opportunities and the company's strategy to address them, climate risk management, and the metrics and targets used by a company to assess and manage climate-related risks and opportunities. Notably, unlike the CSA's 2019 guidance on climate change-related risks, which we discussed in our article "The CSA Releases Additional Guidance on Disclosure of Climate Change-Related Risks," the Proposed Instrument, in its current form, would impose additional reporting requirements on public companies. The public comment period expires on January 17, 2022. A more detailed review of the Proposed Instrument will be issued shortly.

On a provincial level, the Ontario Capital Markets Modernization Taskforce (the Taskforce), which was created in February 2020 to conduct a review of the Ontario capital markets regime, published its final report on January 22, 2021. In the final report, the Taskforce recommended that all non-investment fund public issuers should be subject to mandatory disclosure of material ESG information and specifically, climate change-related disclosure that is compliant with the TCFD Recommendations. The proposal also highlights that the mandatory disclosure would include Scope 1, Scope 2, and if appropriate, Scope 3 GHG emissions on a "comply-or-explain" basis. In March, the Ontario government's provincial budget highlighted that the Ontario Securities Commission (the OSC) would begin policy work to inform further regulatory consultation on ESG disclosure in 2021. In its "2021-2022 Statement of Priorities", the OSC noted that improving climate change-related disclosure was a key priority and highlighted the Taskforce's recommendation in that regard.

United States

In January 2021, shortly after President Joe Biden was sworn into office, he signed an executive order recommitting the United States to the Paris Agreement. Under President Donald Trump, the United States had become the first country to withdraw from the agreement since it was adopted in 2015. The recommitment marked a shift in the White House's climate policies under the new government.

The United States Securities and Exchange Commission (the SEC) has also announced that one of its 2021 examination priorities includes a greater focus on climate-related risks. The SEC has not released any specific climate change disclosure guidance since 2010. In that regard, the SEC appointed its first-ever senior policy advisor for climate and environmental, social, and governance (ESG) and the SEC's Enforcement Division created a 22-person ESG taskforce to monitor for misstatements and material gaps in climate-risk disclosures using sophisticated data analysis. On March 15, 2021, the acting SEC chair announced that the Division of Corporation Finance would carry out a public consultation on climate-related disclosure in public company filings. The comment period ended on June 13, 2021.

Gary Gensler, President Biden's nominee and the current Chair of the SEC, confirmed that 75 per cent of respondents to the public consultation supported mandatory climate disclosure rules. Moreover, in prepared remarks at the "Climate and Global Financial Markets" webinar Gensler compared the SEC's potential guidance on climate-related disclosure to historical changes, such as the SEC's guidance on risk factors. Gensler also confirmed that he has requested SEC staff to develop a mandatory climate risk disclosure rule proposal by the end of 2021, which should be developed in consideration of the following questions:

- Where will the disclosure be required and in particular, will it be required in a company's Form 10-K?
- What qualitative (*e.g.*, how the company manages climate-related risks) and quantitative (*e.g.*, metrics related to GHG emissions or financial impacts of climate change) disclosures should be required?
- Whether there should be any industry-specific metrics required?
- Whether companies should provide scenario analyses on how a business might adapt to physical risks such as climate change?
- Which data or metrics should be required so investors can understand if companies are complying with jurisdictional requirements, such as the Paris Agreement?
- Whether investment funds should be required to disclose what data and criteria they are using to ensure the funds meet investors' targets?
- How external standard-setters, including the TCFD Recommendations will shape the potential SEC rule?

On the final point, Gensler indicated that the TCFD Recommendations may inspire the SEC's path forwards to establish the appropriate climate risk disclosure regime in the U.S. market. With the proposed rule coming as early as this year, it remains to be seen how these questions will translate into a disclosure regime and to what extent the regime will align with the TCFD Recommendations.

Takeaways

There is increasing global pressure for firms to report on climate-related risks and opportunities. Disclosure has largely been voluntary until now; however, governments, regulators, asset owners and financial institutions are moving to make such disclosure mandatory. The TCFD Recommendations are the leading global reporting framework that firms are using to align their disclosure and produce substantive climate-related financial disclosure.

As global and domestic climate change policies continue to evolve, members of our Environmental, Environmental, Social & Governance and Climate Change teams are able to assist you in navigating the legal and regulatory landscape. Reach out to any of the lawyers listed below to discuss any questions you may have regarding TCFD Recommendations and how these changes could affect your business.

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