

TCFD Consultation Paper on Forward Looking Climate Metrics



EUROSIF RESPONSE

JANUARY 2021

Eurosif, the European Sustainable Investment Forum, welcomes the opportunity to respond to the consultation of the Financial Stability Board (FSB) Task Force on Climate-related Financial Disclosures (TCFD) on Forward-Looking Financial Sector Metrics.

INTRODUCTION

About Eurosif

Eurosif works as a partnership of Europe-based national Sustainable Investment Forums (SIFs). SIF members include institutional investors, asset managers, index providers and ESG research and analysis firms totalling over €8 trillion of assets under management, as well as other stakeholders such as NGOs, trade unions, think-tanks and philanthropic foundations. Eurosif is also a founding member of the Global Sustainable Investment Alliance, the alliance of the largest SIFs around the world.

Our Mission is to promote sustainable development through financial markets by supporting the financing through private and public capital of investments that make a measurable contribution to the sustainable development goals set by the United Nations, the European Union and other European countries.

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General comment

We believe that in the efforts to achieve the goals of the Paris Climate Agreement, forward-looking climate metrics, climate scenarios and transition pathway based on reliable Green House Gas (GHG) emissions data can play an important role in ensuring that over time financing and capital is channelled to the necessary investments to achieve the objective of carbon neutrality (net-zero) by 2050.

Forward-looking climate metrics, like Implied Temperature Rise (ITR) indicators, should however not be seen in isolation. Their accuracy and decision-usefulness entirely depend on the alignment objective sought, as well as the credibility of the climate scenario and the transition pathways for specific industries underpinning the metrics.

Therefore, any plan to mainstream the use of ITR and other forward-looking metric needs to go hand-in-hand with a further standardisation of various climate scenarios used and the transition pathways underpinning these scenarios.

At this stage, investors and asset managers are increasingly using these metrics in their investment decision process. However, they are used as one of the many data inputs in the investment process and not as material factor determining whether or not a particular is made or not.

Use and limitations of climate-related metrics

As most metrics, forward-looking climate-related metrics have to be used with full awareness of the implied limitations in their methodologies. These metrics still being developed and improved partly explain why they are not material in mainstream funds investment decision. These metrics are also useful to perform ex-ante assessment, for example for asset allocation decisions, and ex-post assessment to see whether investment portfolios have performed according to pre-agreed metrics.

Some Climate-related metrics favour low-carbon sectors

One key limitation of certain forward-looking climate-related metrics, such as the overall carbon footprint or the Weighed Average Carbon Intensity (WACI) stems from the fact that it captures a physical value (amount of emissions) divided by an economic value (e.g. annual revenue, market capitalisation or undertaking value). Investors and asset managers seeking to minimise this metric will tend to focus on allocating their assets to financially well-performing sectors with relatively low amount of GHG emissions, such as pharmaceuticals or Big Tech companies. It can lead to a strong disincentive to allocate assets to sectors characterised by higher emissions such as energy, transport or heavy manufacturing who are essential to the overall economy and whose successful transition according to a credible pathway have a material impact on the achievement of net-zero by 2050 in any credible climate scenario.

Ideally, forward-looking climate metrics seeking to demonstrate the performance of a corporate issuer compared to peers in the same industry and against credible transition pathway (risk of overshoot or not) are likely to be more decision-useful metrics than those focussing on carbon intensity or carbon footprint in absolute terms.

The lack emissions data

Another barrier to the use of climate-related metrics remains inconsistent and incomplete data around GHG emissions by corporate issuers. In the future, more corporate issuers should disclose this type of data and also be able to provide more accurate disclosure also on Scope 3 emissions and possibly Scope 4 emissions.

Climate metrics have to be part of a broader holistic assessment

Finally, it is worth remembering that forward-looking climate-related metrics are part of a greater effort at disclosing environment sustainability metrics, as climate is only one of several environmental challenges. A climate-only approach focussing only on GHG emissions carries the risk of having unforeseen consequences for other environmental objectives such as biodiversity, air quality, water-related or waste issues. We therefore support in the future having forward-looking climate metrics

as part of a more holistic set of forward-looking metrics such as life-cycle analysis (LCA), the 6 EU environmental objectives underpinning the EU Taxonomy (Climate change mitigation, Climate change adaptation, Sustainable use and protection of water and marine resources, Transition to a circular economy, waste prevention and recycling, Pollution prevention and control, Protection of healthy ecosystems, on which the EU taxonomy is based) and the Planetary Boundaries (erosion of biodiversity, disruption of the global nitrogen and phosphorus cycles and changing soil uses).

RESPONSE TO QUESTIONS

1. Which types of financial organizations should disclose forward-looking climate-related metrics? That is, which would be most useful to you? Select all that apply.

- Asset owners
- Asset managers
- Banks
- Insurers
- None
- Other (please specify):

Is there anything additional you would like to tell us about your responses above?

Risks linked to climate change are relevant to each financial organisation, whether they fund economic activities through asset allocation, equity and bond underwriting, lending or risk underwriting (insurers and re-insurers). Over time, we believe that all types of financial organizations should disclose forward-looking climate-related metrics. However, it seems for now that disclosures of forward-looking climate-related metrics from asset managers are the most useful, considering the issue of potential double counting of exposures to particular corporate issuers and economic sectors between asset owner and asset managers.

2. Currently, the TCFD supplemental guidance encourages asset owners to disclose “metrics considered in investment decisions and monitoring.” In your opinion, who else should disclose such metrics?

- Asset managers, for investment decisions and monitoring
- Banks, for lending decisions and monitoring
- Insurance companies, for underwriting decisions and monitoring
- None
- Other (please specify):

Is there anything additional you would like to tell us about your responses above?

We support the idea that asset managers, banks and insurance companies would be required to disclose such metrics. In doing so, it is likely that these companies would rely quite significantly on the data, scenarios and solutions provided by ESG data providers. Therefore, we argue it will be critical to ensure adequate levels of transparency by data providers regarding their methodologies, the scenarios used, and the quality of the data used. This is particularly important to allow for comparability across data providers, given differences in methodologies they use.

Now, we have a few questions about the usefulness of various metrics and challenges associated with these metrics.

3. How do you currently view disclosure for forward-looking climate-related metrics?

- The challenges outweigh the benefits
- Challenges are proportionate to the benefits
- The benefits outweigh the challenges *now*
- The benefits *will* outweigh the challenges if there is further standardization of metrics

Is there anything additional you would like to tell us about your response above?

At this stage of market development, we consider forward-looking climate-related metrics as being useful information that asset managers and investors can integrate into their investment decision making process. However, it is also clear that most of these metrics still are in development and come with their share of limitations that investors have to be aware of. Existing metrics are different, provide heterogeneous outputs and their ability to provide information about transition risks are unclear. Current metrics are therefore not yet fit to be used for specific regulatory requirements in prudential or market conduct regulation. However, we would argue that it would be useful to link it to TCFD-type transparency requirements in financial and non-financial reporting. We believe it is important that further initiatives encouraging the development and use of these metrics should be supported as a way of bringing more transparency to financial markets on climate-related risks. Further work also needs to be done around standardising different credible top-down and bottom-up climate scenarios, as well as different sectoral transition pathways. That will in turn also a better development of forward-looking climate metrics.

4. How does the lack of reliable or comparable GHG emissions data impact the usefulness of forward-looking metrics as part of financial decisions?

- It's a significant barrier
- It's somewhat of a barrier
- It's not much of a barrier
- It's not a barrier at all
- I don't know

Is there anything additional you would like to tell us about your response above?

5. Which GHG emissions scopes should be covered in an ideal forward-looking methodology for metrics related to emissions? Select all that apply.

- Scope 1
- Scope 2
- Scope 3
- None

Is there anything additional you would like to tell us about your responses above?

It is important to emphasize that the relevant scope is related to the underlying economic activity. The materiality of different scope of emissions will differ per sector: for energy producers, scopes 1 and 2 are key. For a car manufacturer, the scope 3 downstream is the main part of the scope with 80% of GHG emissions of a car in a life-cycle approach (and 3% for scopes 1 and 2). For food products, scope 3 upstream represents the main share. On the other hand, for recyclers and producers of insulation materials, the key factor is by far the avoided emissions (Scope 4). Importantly, for some sectors having the objective of alleviating GHG emissions, the classification of GHG emissions across Scope 1 and Scope 2 can be inconsistent indicators of the extent to which these companies participate in reducing GHG emissions at the society level. It is reasonable to conclude that no ideal unique forward-looking methodology could apply to all sectors at once. We therefore advocate for a sector-specific metrics framework that covers the scopes.

6. How important is it to understand which scenarios and pathways were used in the calculation of forward-looking metrics to make them decision-useful?

- Very important
- Somewhat important
- Not very important
- Not at all important

Is there anything additional you would like to tell us about your response above?

This is very important. By definition, forward-looking metrics are seeking to bring some clarity to an uncertain future. They are a set of predictions about the future based on different assumptions, scenarios and pathways to stay within a 1.5°C temperature rise by 2050. For example, some scenarios may be aligned with the 1.5°C objective. The scenario may not be aligned with the objective of the Paris agreement because of the transition path it follows, for example because it remains business as usual before a sharp and short transition. Finally, some scenarios may be fully aligned with the Paris Agreement as it also takes into account the different efforts that different countries have to undertake.

Forward-looking climate metrics are only useful to the extent that the assumptions and pathways used are realistic or in line with broadly accepted scenarios to reach net-zero by 2050. While some trade-offs between different economic sectors are possible in these scenarios and unknowns such as the maturity and rollout of new low-carbon technologies exists for some of the high emitting sectors, there is not much room for discretion to reach net-zero in 2050. As a result, the scenarios and pathways used are vitally important as they determine the relevance and quality of the forward-looking metrics, and consequently whether they could be decision-useful or not.

7. Which of the following metrics do you find useful for financial decision-making?

| | Useful now | Could be useful with improvements to methodology | Not useful |
|---|-------------------------------------|--|--------------------------|
| Climate Value-at-risk | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| A forward-looking estimate of the amount or percentage of carbon-related assets in each portfolio over the course of their planning horizon | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| Carbon earnings at risk | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Amount of apportioned emissions over/under at 1.5°C alignment trajectory | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Implied temperature rise or warning potential | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| The proportion of underlying investments that are aligned with the EU taxonomy | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| Unpriced carbon cost | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Other (please specify) | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

Is there anything additional you would like to tell us about your responses above?

It is often asserted that the path towards more disclosure in financial markets and potential consequent re-allocation of investments towards more sustainable assets shall be guided by the present use of imperfect tools rather than future use of perfect (or best) ones.

This leads us to believe that ITR would be useful now even acknowledging that this metric requires improvement.

It is generally the case that the amount of apportioned emissions over/under a 1.5°C alignment trajectory is useful in theory, but it requires a difficult methodology in practice, which often impairs its attractiveness as a metric.

As of 2022, all investment funds offered to investors in the EU and having sustainable investment as their objective or pursuing environmental or social characteristics will have to disclose in how far their investment portfolio aligns with the EU Taxonomy. While this undoubtedly will bring much needed transparency to the market, a significant data-challenge remains with the application of the Taxonomy due to a lack of comparable, reliable and verified data from investee companies. As a result, the initial disclosures will remain imperfect for a while. But that is probably no different from the other methodologies listed here. The advantage over time is that the Taxonomy may provide a more 'holistic' picture of sustainability as it will also incorporate other important environmental objectives such as the protection and restoration of forest and biodiversity.

Finally, the use of unpriced carbon price as a metric does not seem as useful as previous ones given that it attempts to materialise a direct financial risk (the rise of the carbon price) that is non-existent at the moment. This metric relies on the assumption that the carbon price will eventually rise, which is too uncertain to be the cornerstone of a financial metric. In the similar category, we are not in favour of metrics based on carbon intensity or carbon footprint as it may artificially drive investors towards shares of companies with traditionally low-carbon business models, whereas the transition to net-zero will require the carbon-intensive industry to change.

8. Which of the following metrics would you find useful if disclosed by the following groups?

A forward-looking estimate of the amount or percentage of carbon-related assets in each portfolio over the course of their planning horizon

- Asset owners
- Asset managers
- Banks
- Insurance companies
- None
- I don't know

Implied temperature rise or warming potential

- Asset owners
- Asset managers
- Banks
- Insurance companies
- None
- I don't know

Please provide any additional information about your responses above or on what else would be useful to you.

9. Which of these changes would improve the usefulness of forward-looking disclosures for you?

- More comparable approaches to calculation methodologies
- Better availability and quality of GHG emissions data
- More clarity and transparency in calculation methodologies
- Use of standard forward-looking emissions pathways
- More useful narrative content
- Other (please specify):

Now, we would like to ask a few questions about implied temperature rise (ITR).

10. To what extent does your organization find current ITR disclosures useful in financial decision-making?

- Very useful
- Somewhat useful
- Not very useful
- Not at all useful
- Not applicable/I don't know

11. Has an ITR rating influenced a specific financial decision your organization has made?

- Yes
- No
- I don't know
- Other (please specify):

Please provide any further information on why an ITR rating has or has not influenced a decision, as applicable.

At this stage, ITR ratings are not material factors influencing investment decisions for mainstream funds, such as buy or sell decisions, partly because they are very heterogeneous. For sustainable investment funds, climate metrics are generally used to align a portfolio with some climate scenario. It is therefore reasonable to say that the use of climate metrics serves mainly to influence the composition of a portfolio that meets a relatively positive climate scenario ex-ante, but not to reposition a mainstream portfolio far from reaching the requirements of a 1.5°C or 2°C alignment.

12. What are the benefits of ITR as a metric? Select all that apply.

- Comparability at different levels (e.g., fund, portfolio, company, other)
- Useful for engagement
- Useful for assessments of strategy
- Useful for assessing climate-related risks
- Easy to understand
- Useful for assessing climate-related opportunities
- There are no benefits
- Other (please specify):

Is there anything additional you would like to tell us about the usefulness of ITR as a metric?

13. How much would each of the following improve the rigor and usefulness of ITR disclosures?

| | Improve a lot | Improve a little | Would not improve |
|---|-------------------------------------|--------------------------|--------------------------|
| Better availability and quality of CHG emission data | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| More clarity and transparency in calculation methodologies More comparable approaches to calculation methodologies | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Use of standard forward-looking emissions pathways | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

Please provide any additional information about how the rigor and usefulness of ITR disclosures could be improved.

14. How useful would disclosure of an ITR rating be from the following types of financial organizations?

| | Extremely useful | Very useful | Somewhat useful | Not very useful | Not at all useful |
|-------------------------------------|--------------------------|-------------------------------------|-------------------------------------|--------------------------|--------------------------|
| Asset owners | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Asset managers | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Banks | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Insurance companies | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Index providers | <input type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Other organisation (please specify) | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

Please provide any additional information about how disclosure of an ITR rating from a financial organization could be useful.

As mentioned above, we are aware of the inherent limitations of the different ITRs due to further evolving methodologies and the availability of data from non-financial companies. However, the disclosure of traceable ITRs (methodology used, entity accountable for the calculation, year of input data, perimeter covered, ...) would nevertheless provide useful information to investors. First, it would send a clear signal to financial markets that a company is seriously considering the effects of climate change. Second, the methodology and its scientific base (scenario, transition pathway or framework) used by a company would show how realistic a company's strategy and plans are with the prospects of a net-zero economy in 2050. This in itself would be very valuable information for investors.

15. How useful would an ITR rating be for each of the following asset classes?

| | Extremely useful | Very useful | Somewhat useful | Not very useful | Not at all useful |
|------------------------------------|--------------------------|-------------------------------------|-------------------------------------|--------------------------|--------------------------|
| Mortgages | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Listed equity | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Sovereign debt | <input type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Real estate | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Loans to corporates | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Listed debt | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Other asset class (please specify) | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

Is there anything additional you would like to tell us about your responses above?

The more an ITR metric can be applied across asset classes, the higher the usability and usefulness for the finance industry. As currently we already have a dozen different ITR for listed equity, there is little hope of getting any convergence or understandability if the same diversity is expected for all other asset classes. This cross-asset ability will be also key for assessing carbon neutrality claims that have started to raise from both corporate and non-corporate entities (states, regions, EU, local authorities). If the application of the ITR across asset classes is not feasible, ITR ratings would have to be compared only with assets in the same asset class to make sense.

Nonetheless, while forward looking ITR metrics might at some point be very useful for specific companies (equity/debt), and for specific projects, it may be more challenging to assess sovereign issuers, depending on whether the assessment covers governmental operations from the sovereign itself, or the overall alignment of the economic activity in that sovereign's territory with a 2050 net-zero scenario.

16. For each sector listed below, how useful would you find an ITR rating in financial decisions?

| | Extremely useful | Very useful | Somewhat useful | Not very useful | Not at all useful |
|--|--------------------------|-------------------------------------|--------------------------|--------------------------|--------------------------|
| Materials and buildings | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Energy | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Transportation | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Agriculture, food, and forest products | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Other sector class (please specify) | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

Is there anything additional you would like to tell us about your responses above?

We agree with the suggested sectors including automotive, aviation, basic materials & cement in the Materials and Transportation macro-sectors as these are commonly identified at some of the sectors that will be critical to the transition to a net-zero economy by 2050. We would however add that manufacturing information technology (data centres, hardware, telecommunications ...), beverages, apparel & textile, chemistry, heavy industry (metal refining, recycling ...), waste management and, last but not least, the financial sector would have to be integrated also as sub-climate-relevant sectors that would be useful to cover.

17. How useful would disclosure of an ITR metric be at each of the following levels?

| | Extremely useful | Very useful | Somewhat useful | Not very useful | Not at all useful |
|---|-------------------------------------|-------------------------------------|--------------------------|--------------------------|--------------------------|
| Company level | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Portfolio level | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Fund level | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Investment strategy level | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Asset level | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Other level class (please specify): asset managers, asset owners, indexes | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

Is there anything additional you would like to tell us about your responses above?

For asset managers and investors, the most decision-useful information is at company level as investors tend to invest in equity and debt securities from issuers. Once that information is available, it would be possible to construct the metric through appropriate weighting and methodologies for the portfolio, fund and investment strategy level up to the index level to enable comparison to benchmarks. We would note that a similar metric might also be useful for specific projects, particularly in the infrastructure and project finance area. At company level, the metric might be useful to assess how a company is in control of its own transition pathway. For specific infrastructure projects, the metric would be useful to understand how far it is compatible with a net-zero 2050 climate scenario or whether its lifespan might be shorter than expected.

ABOUT EUROSIF

Eurosif is the leading European association for the promotion and advancement of sustainable and responsible investment making a measurable impact in meeting long-term sustainability goals of the EU and the UN.

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