AFME feedback on the TEG's report on Climate-related Disclosures

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AFME and its members welcome the opportunity to provide feedback to the Technical Expert Group's Report on Climate-related Disclosures ("Report"). It is important that the Technical Expert Group and the European Commission continue to explore ways to ensure that issuers and users of climate-related disclosures are fully comfortable with the proposed guidelines, and will be important to assure the uptake of the recommendations.

AFME is supportive of the objective to develop better voluntary disclosures, focused on materiality, to improve investment and lending decision-making through the Non-Financial Reporting Directive, the industry-led FSB TCFD work as well as additional existing national, EU-based and international frameworks (as set out in the European Commission's Guidelines on non-financial reporting, page 3). We therefore provide our comments to different sections of the Report as follows below.

As a preliminary matter, we recognise that the TEG's recommendations will interact with the package of measures that form the EU's Action Plan on Sustainable Finance. In some instances, there will be a co-dependency on the regulations, such as the proposed taxonomy, and the disclosures recommended by the TEG. We suggest that the implementation of the TEG's proposals is suitably aligned with the delivery of the Action Plan, allowing for the TEG and other regulators to provide the clarifications and consultation that we believe is necessary.

CHAPTER 1.5: Companies in Scope

AFME would like to seek clarification regarding the scope of companies subject to the disclosure requirements proposed by the Report. The Report states that "the NFRD applies to large Public Interest Entities (PIE) – listed companies, banks, insurance undertakings, and other entities identified by member states – with more than 500 employees" and that "the TCFD recommends all companies with public debt or equity as well as all other organizations, especially asset managers and asset owners, implement its recommendations…". It is unclear whether it is expected that these requirements should thus be applied at a standalone entity level and whether group reporting might not be viewed as sufficient. We would recommend a phase approach targeting corporate sector first and then moving on to financial institutions because the latter are dependent on the former to assess their own climate related risks.

CHAPTER 2: Disclosures under the Directive: Principles and Rationale for Non-financial Reporting

AFME believes that Chapter 2 generally represents a faithful interpretation of the TCFD. AFME strongly supports the TCFD recommendations which are being implemented already by more than 500 firms globally noting that TCFD currently focusses on the four main areas we believe are of interest to investors, such as governance, strategy, risk management, data and metrics. We note nonetheless that a survey of 1,700 global businesses and investors found that only 8% of big companies and 10% of investors were aware of the TCFD (source: HSBC Research / East Partners, September 2018). The EU's initiative set out to provide further clarity on how to disclose climate-related risks and opportunities with an objective to align it with the TCFD is therefore very much welcome.

Referring to the alignment with the TCFD, AFME notes that the Report does not provide specific sectoral Type 1 disclosure guidance for asset managers and no specific guidance at all for asset owners. Given the fact that "the TCFD recommends all companies with public debt or equity as well as all other organizations, especially asset managers and asset owners, implement its recommendations…", a clarification would be welcome on the reasons why the relevant recommendations have not been provided by the TEG.

AFME notes that the TEG guidance correctly states that the TCFD is concerned with the impacts of climate risks on the disclosing institution. Complementary to TCFD disclosure, the TEG adds guidance for disclosure of a company's impact on the climate. While this makes sense from the perspective of a broader group of stakeholders (which the NFRD has in mind), we note that the reporting practices on such impact are not yet as clearly developed as the TCFD recommendations. Where guidance exists, such as with scope 3 emissions/financed emissions reporting, it is fraught with methodological flaws (i.e., boundaries, double counting), and which the TEG acknowledges itself on page 39 of the Report with the qualification "despite the well-known challenges associated with it". Therefore, AFME emphasises the importance of clear and consistent reporting guidance as it would help entities produce more relevant and comparable disclosures.

Additionally, we believe that the proposed guidance goes beyond any reporting practices currently applied, i.e. TCFD-aligned disclosure, which forms the core of the guidance, is only starting to evolve. It would impose a significantly higher reporting burden on affected companies in EU jurisdictions compared to the rest of the world and could put these companies which have to disclose more about the risks they face at a competitive disadvantage.

As noted above, the TEG guidance focuses on disclosure related to climate change, largely and rightly mirroring the TCFD recommendations. However, the TEG guidance also contains disclosure recommendations on water, deforestation, biodiversity loss, pollution, land use, etc. These topics, for which the reporting practices and metrics have not been established yet, nor described in any useful level of detail in the TEG guidance, lead to confusion in the guidance. It is our view that under the title of "Report on Climate-related Disclosures" companies should not be required to report beyond climate impacts, however which does not prevent them from doing so voluntarily.

Although the Report acknowledges relevance and materiality as a consideration for disclosures throughout the chapters, it needs to be made clear that climate-related financial disclosures necessarily need to be made subject to established principles of relevance and materiality analysis. AFME would like to emphasise that disclosure should be made where material and relevant, and firms must continue to have the right to make judgments about what is relevant and material to their investors and creditors, and thus to be able to define materiality thresholds for physical and transition risks. How climate materiality factors are incorporated in the investment and lending process requires judgement and an integrated approach ensuring that the focus is on customers and on the issues that have the largest impact. This approach would help to avoid information overload or excessive disclosures that would rapidly become of little value to users. This is essential to achieve appropriate balance and efficiency to support the intended use of the disclosures. It could be helpful for the industry to work with other stakeholders to develop guidance that would help firms make reasonably consistent determinations of whether climate-related risks are material financially to their businesses.

AFME welcomes and appreciates the fact that the Report recognises the importance for firms to ensure information comparability and consistency. At the same time, the Report should acknowledge that such comparability and consistency will be difficult to achieve, especially in all those aspects where the TEG guidance (applicable to EU jurisdictions) goes beyond the TCFD recommendations, given the many unknowns related to climate, the degree of judgement that each organisation would have to apply and the aspiration of comparability across organisations, jurisdictions or even within the same sectors. The current wording used in the Report before each requirement in Chapter 4 ("companies should include consistent and historical disclosures") fails to recognise the difficulty in comparability and consistency that companies will face. This difficulty will be particularly true when using scenario analysis for climate-related risks and opportunities, even if there is some degree of standardisation of reference scenarios. We therefore agree with the Report's observations that the use of scenario analysis is "relatively recent in most industries" and will vary "by industry […] and assumptions made" (p.11) - although it is possible to expect that projections, analysis, and disclosures practices may converge over time as firms learn from experience and as understanding of the risk presumably grows.

CHAPTER 3: Alignment of NFRD and TCFD

As previously noted, AFME strongly supports the alignment of the NFRD with the TCFD recommendations exhibited in the Report, over a sensible timeframe. We would like to note though that the TCFD recommends that disclosure is included in financial filing while NFRD's vision was primarily around non-financial reporting. Therefore, it is important to ensure that a clear focus is kept on the TCFD requirements in the development of a robust climate-related disclosure framework. For example, AFME finds the juxtaposition of NFRD elements and TCFD recommendations in the Report very helpful.

We also appreciate that the Report consistently notes the alignment with other existing reporting frameworks which will be fundamental to the quick and wide adoption of the new guidelines. In particular, the KPIs / metrics and targets will be key for businesses to track, assess and manage climate-related risks and opportunities whilst giving investors and lenders the necessary data to make investment and lending decisions. The following alignments should be particularly taken into consideration, though the alignment with TCFD is considered the most fundamental and of the highest priority:

- G20/OECD Principles of Corporate Governance: 6.d.1, 6.d.7
- CDP Climate Change Questionnaire 2017: CC2.1c, CC2.1d, CC2.3, CC12
- GRI 102: General disclosures: 102-30
- CDSB Climate Change Reporting Framework: 2.36, 2.37, 2.38, 4.14, 4,15
- CDSB Framework for Reporting Environmental Information and Natural Capital: REQ-01, REQ-04, REQ-05, REQ-04
- International Integrated Reporting Framework: 3.52, 3.53, 4.30, 4.31, 4.32, 4.38, 4.53

CHAPTER 4: Proposed Disclosures

We view the distinction between Type 1 disclosure (disclosure by all companies) and Type 2 disclosure (disclosure by "companies with significant exposures to climate-related risks and opportunities") as useful but recommend providing a description of what is meant by the latter, in terms of industry sector or business activities. We would also welcome additional guidance of the level of prescriptiveness of Type 2 disclosures, clarifying whether entities would still need to make a statement in their reporting as to how they considered Type 2 disclosure requirements even when they chose to not disclose such information.

In contrast, we take a critical view of the Type 3 disclosures in the TEG guidance, as they are positioned in the Report as such that would be good to have and provide not very specific suggestions of what companies may voluntarily choose to report on. Our view is that such recommendations may not necessarily need to be part of the TEG core disclosure guidance but can be aggregated in a separate section as a supplement providing additional disclosure options for consideration.

CHAPTER 4.1: Business Model

AFME believes that disclosure needs to balance the risk and opportunity presented by the transition to a low carbon economy, which we think the Report does.

However, we note that the TEG guidance for disclosure on a company's business model goes beyond the TCFD recommendations and reaches a level of granularity that could pose a problem for reporting entities due to the additional reporting burden, but also because it recommends disclosure of information that may be commercially sensitive. Other areas in the TEG guidance that require disclosure of potentially commercially sensitive information concern the disclosure of sectoral or company-specific KPIs relevant to a company's particular business and circumstances. Additionally, The TEG may want to review the balance between Supplementary Disclosure (Type 2) and Other Disclosure (Type 3), in that we believe that the Type 2 Disclosure will be potentially more onerous than the Type 3 Disclosure due to the requirement to disclose "business segments". More guidance would be welcome here as to how this would be implemented, and how materiality would apply.

More broadly climate change risk manifests itself in multiple ways and through many channels and it will take a number of years to collect and collate the necessary customer, economic and scientific data and develop the systems and modelling capabilities. We would therefore recommend that the TEG focus on Type 1 Disclosure to allow the industry to align and evolve, before bringing in the 'should consider' and 'may consider'. We foresee a multiyear journey dialogue between the issuers, financial market participants, regulators and policy makers, which will allow us to revisit the ambition of disclosure across Type 1-3.

CHAPTER 4.2: Policies and Due Diligence Processes

Under "Supplementary Disclosure (Type 2)" AFME would argue that the board should not just demonstrate "climate competency that exists at board and top management level" but climate competency it "has access to". We would argue that boards may find it desirable to have access to expertise rather than for example one person of expertise at the board level.

In addition, under Type 2 we would seek clarity as to what "historical disclosures" means. We believe that the disclosure should reflect the forward-looking nature of firms' decisions to integrate climate related issues into mainstream risk management processes.

CHAPTER 4.3: Outcomes

Given the inherent uncertainties of climate change impacts, the assessment here should capture mid to long term risks only in qualitative terms.

We agree with the use of metrics and targets, but we expect the metrics and tools to evolve and mature over time to incorporate climate change risk to inform our strategy and risk appetite. Flexibility and a non-prescriptive approach will provide the opportunity to ensure the right outcomes.

CHAPTER 4.4: Principal Risks and Their Management

As mentioned above, given the inherent uncertainties of climate change impacts, the assessment here should capture mid to long term risks only in qualitative terms.

The use of "historical" disclosures will also be complicated by the lack of available data.

CHAPTER 4.5.1: General and Supplementary KPIs

We believe that the Report captures the right KPIs. The availability of client level, industry and economic climate change-related data are factors likely to impede the pace and quality of climate-related analyses and disclosures.

For the financial sector, the quality of our disclosure is dependent on the quality of our clients' disclosure. Therefore, our ability to provide scope 3 information is dependent on the quality of engagement with clients but also robust frameworks, such as this Report, to drive the granular reporting.

CHAPTER 5: Sector specific Guidance: Banks and Insurance Undertakings

AFME agrees that bank specific guidance should focus on risks and opportunities.

Bank specific guidance needs to be seen in the context of the TCFD guidance for banks, but also in Europe within the evolving landscape of regulatory change, such as the EU Taxonomy and the amendments to Capital Requirements Regulation ("CRR") around incentives and ESG integration into the Supervisory Review and Evaluation Process ("SREP").

Bank guidance should therefore focus on banks defining their materiality threshold to ensure that disclosure is focused on the most relevant issues.

We also consider that there are specific recommendations in the Report which should not be taken forward. With regards to business models (5.1, "whether the institution gives preference to counterparties with climate resilient strategies"; and policies and due diligence (5.2, "should consider disclosing climate-related incentives in risk and commercial teams"), we do not feel appropriate that financial institutions should disclose incentives. We see this as a reference to the debates on "incentives", which we argue is still in its infancy and any requirement to discuss counterparty preference would be premature and may lead to unintended consequences, for instance by disincentivising lending to customers needing finance to transition to lower-carbon operating models.

With regards to the principal risks and their management (5.4, "Collateral"), we do not support recommendations to disclose collateral policy as part of our members' internal risk management purposes. With a view as to the likelihood and impact of the risks materialising, our members may look at collateral, but would not envisage disclosing, and would not see the value it would provide to disclose them while possibly taking effort away from members' actual risk management practices.

CHAPTER 5.1: Business Model

We do not feel it is appropriate for financial institutions to consider disclosing "whether the institution gives preference to counterparties with climate resilient strategies". We feel the debate on incentives is still at a very early stage and any requirement to discuss capitalisation of loans would be premature and may lead to unintended consequences, e.g. disincentivising lending to customers needing finance to transition to lower-carbon operating models.

CHAPTER 5.2: Policies and Due Diligence

In line with our comments above, we do not feel it is appropriate that financial institutions "should consider disclosing climate-related incentives in risk and commercial teams". Whilst we agree that financial institutions may set targets for sustainable financing – this is different to disclosing what level of incentives they apply. Once again we are concerned that this leads to a distorted focus on "incentives" vs. "penalties" and is not a prudent risk management approach to credit analysis. Moreover, EU regulations on the integration of ESG risks into the business models of various types of financial institution are being created. These regulations will determine the rules governing matters such as conflict of interest policies. It would be premature, and could be counter-productive, to attempt to deal with similar matters under this standard.

CHAPTER 5.4: Principal risks and Their management

AFME supports financial institutions describing how climate related risks are integrated into the overall risk management framework, but we do not support on the incorporation of ESG factors at this stage. In line with comments above there is a developing regulatory response in Europe, of which ESG is part, but we feel that there is no consistency of definitions or approach to what ESG means for credit analysis. As a result, more work and clarification by the TEG with the EBA and ESRB as well as the current work undertaken to build a Taxonomy for environmentally sustainable economic activities will be required to ensure that this work could be taken forward in a meaningful way.

ADDITIONAL COMMENTS

AFME notes that the availability of client level, industry and economic climate change-related data presents obstacles to firms' ability to embed climate change within their risk management processes and integrate financial with non-financial disclosures. Companies will need to review their internal controls and systems for gathering non-financial qualitative and quantitative data. As a result, we foresee a multi-year journey for firms to collect customer data, establish relationships with external data providers and to integrate this with existing systems and models. This information will be essential to insightful statements of risk appetite and the quality of respective reporting.

For this reason, we strongly support the work of the TEG and this climate-related disclosure Report as we strongly support initiatives that seek to accelerate adoption of the TCFD.

Therefore, we need to ensure that the frameworks and guidance put in place are robust and as relevant to preparers and users of the data. With that in mind, it is important to ensure that the disclosure requirements provide companies with the flexibility to reflect on the information related on climate-related risks and opportunities in a specific, tailored manner. At the same time, it is equally important to ensure that disclosures produced by firms are not too generic and "boilerplate" as this will further impede the usefulness and meaningful comparability of such information.

Additionally, AFME notes that the Report has very rightly placed a large focus on the financial sector, but equal weight needs to be paid to the non-financial sector, who themselves may be unfamiliar with forthcoming disclosure requirements. As noted within our previous comments, the quality of banks' data relies on the quality of their clients' data. The prerogative therefore should be on facilitating and engaging with the non-financial sector to deliver more meaningful disclosure.

AFME notes that the disclosure requirements should be developed with a view that such information could be subject to third-party assurance, and therefore should be auditable in accordance with relevant recognised assurance standards, already existing or those to be developed further.

Finally, AFME believes that the decision of the TEG to allow only a two-week response period for the Report was regrettable and might not have allowed a wide range of stakeholders to conduct and provide feedback based on a more comprehensive analysis related to the proposals in the Report. We would welcome and be ready to support an enhanced financial sector consultation on the TCFD and broader disclosure issues for the industry.

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About AFME:

AFME (Association for Financial Markets in Europe) advocates for deep and integrated European capital markets which serve the needs of companies and investors, supporting economic growth and benefiting society. AFME is the voice of all Europe's wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues. AFME aims to act as a bridge between market participants and policy makers across Europe, drawing on its strong and long-standing relationships, its technical knowledge and fact-based work. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) through the GFMA (Global Financial Markets Association). For more information please visit the AFME website: www.afme.eu.