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PRINCIPLES FOR TCFD AS APPLIED TO SOVEREIGN AND PUBLIC ENTITIES

CFA BRIEF

CLIMATE FINANCE ADVISORS

HOW WE INVEST MATTERS

KEY MESSAGES

- The Task Force on Climate-related Financial Disclosures (TCFD) recommendations are not only disclosure guidelines, but also provide a framework for identifying, assessing and managing climate risks and opportunities.
- The TCFD recommendations have untapped potential to apply to other entities, including sovereigns and public entities. The TCFD framework can help sovereign and public entities formulate and achieve their climate goals as well as guide the execution of climate strategy and investment plans.
- Sovereigns, sub-sovereigns and other public sector entities may find employing the TCFD framework can improve transparency with investors. The TCFD can also help to identify, assess, quantify and manage climate-related risks, and ensure governance systems and metrics are in place to manage climate-related issues.

Climate Finance Advisors' mission is to accelerate sustainable, climate-aligned investment to the benefit of society, the economy, and the global environment. Established in 2015 as a Benefit LLC, CFA is a women-owned consulting and advisory firm specializing in helping our clients develop climate finance strategies, appraise and structure climate-aligned investments, channel public and private capital to sustainable investment, and integrate climate considerations into investment decisions, financial products and services, and policies. **For more information, please contact Christina Stanton, Chief Operating Officer, Climate Finance Advisors, Christina@climate-fa.com.**

INTRODUCTION

Both the physical effects of climate change as well as the transition risks associated with the impact of policies, regulations and technological advances can significantly impact on local, state or national entities. These impacts can affect economic, financial, and fiscal conditions, particularly in locations vulnerable to transition risks, or physical hazards (e.g., sea level rise, drought, wildfires, hurricanes) as well as areas exposed to transition risks.

Addressing climate change will require "[m]aking all finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development,"[1] and involve aligning the capital markets and the entire financial system to the net-zero, climate resilient transition. This includes public financial flows, such as public investments in infrastructure, and the use of national and local budgets.

Policymakers, including the G20, the Financial Stability Board (FSB), and other financial regulators, have begun to incorporate climate considerations into financial policy decision-making, primarily with the aim of enabling greater transparency around climate-related financial risks from corporates and financial firms. However, such information is equally important for the act of policymaking and can help those tasked with deploying the public funding to do so more effectively towards overall climate for as well as sustainability goals.

The Task Force on Climate-related Financial Disclosures (TCFD) recommendations have gained momentum as a way to understand, assess and manage and (where applicable) disclose climate-related financial risks. To date, the application of the TCFD framework has been focused on addressing the information gap between investors and corporate and financial institutions. However, as a paradigm for organizing and presenting information about climate-related financial risk and opportunities, TCFD can be equally relevant for sovereign entities, and useful for a broader range of stakeholders, including different types of investors in public assets, and international policymakers.[2]

The following presents the rationale for employing a TCFD-aligned framework for sovereigns, and principles that may be useful should one emerge in the future.

The brief is part of research undertaken by CFA for the World Bank Global Program on Sustainability and benefits from input and review from World Bank staff. The World Bank will publish its report on the topic, 'Towards Effective Climate- and Nature-Related Risk and Opportunities Reporting: Adopting a Framework for Sovereigns,' later in 2021.

RATIONALE FOR A TCFD FOR SOVEREIGNS

A TCFD-aligned framework for sovereigns would help sovereigns develop and implement comprehensive climate risk management plans, as well as inform their strategies to develop climate-related investment pipelines and economic development, and provide greater transparency about such plans. Such plans are also becoming increasingly important for investors of all types. A TCFD framework for sovereigns would be useful for reasons related to policy drivers as well as investment and risk management.

POLICY DRIVERS

Sovereign reporting of climate-related financial and economic information can inform a state's climate action, and benefit policymaking at local, sub-national, national, and international levels. And importantly can be useful for monitoring progress towards the Paris Agreement goals.

Investors and other stakeholders will seek sovereign-level climate information, particularly as climate change risks increase in the future. This information exists but remains fragmented in economic plans, environmental plans, climate-impact assessments, and Nationally Determined Contributions.

Understanding climate-related financial and economic risks can strengthen policy coherence at the national level, and ensure consistency between countries' NDCs and plans to address climate transition and physical risks.

INVESTMENT AND RISK MANAGEMENT DRIVERS

Demands for climate-related financial information by investors is growing, including for sovereign bonds and investor flows (i.e., a significant source of foreign direct investment).

Good climate-risk management plans can attract investors, particularly if coupled with strong governance, metrics and forward-looking climate positive investment strategies. Conversely, the absence of climate-related risk management plans can worsen risk perceptions among investors.

Development and application of a TCFD framework for sovereigns an make capital allocation more efficient and help identify priorities where capacity needs to be reinforced.

THE POTENTIAL RISK OF UNINTENDED CONSEQUENCES

Ideally, a better understanding of physical and transition climate-related risks would improve policy outcomes and ensure a more efficient supply of finance, including for foreign direct investment and development aid. However, surfacing climate-related risks – without a plan to address those risks – may only serve to heighten investor caution, raising the cost of capital for countries that need investment to adapt.

Capital flight remains a serious potential risk for sectors and communities with high exposure and vulnerability to climate change that do not develop a plan to address climate change in their jurisdiction. However, not identifying or managing climate change risks only obscure them, leading to mispricing and higher capital costs.

Given the evidence that climate-related risks have started to influence sovereign bond spreads, the challenge for policymakers and others will be to ensure they fully identify, assess, and manage the climate-related risks proactively, and enable such informed views to drive climate investment strategies.[3]

PRINCIPLES

The following is a set of principles for the development of a TCFD-aligned climate risk management and disclosure framework, as it may apply to sovereigns.[4]

1	Climate-risk management and disclosures should present relevant information	Sovereigns should provide information specific to the potential impact of climate risks and opportunities on their key economic sectors, markets, businesses, national development and investment plans, and economic growth prospects over relevant time horizons.
2	Disclosures should be specific and complete	Sovereign reporting should provide a thorough overview of their exposure to potential climate impacts (both transition and physical); the potential nature and size of such impacts; the sovereign's governance, strategy, climate-related risk management processes, and metrics by which they will monitor and measure performance with respect to managing climate risks and investment opportunities.
3	Disclosures should be clear, balanced, and understandable	Sovereign disclosures should be written with the objective of communicating financial and other relevant non-financial information that serves the needs of a range of stakeholders, including investors, lenders, insurers, and other public stakeholders over meaningful time horizons, including short (1-3 years), medium (3-5 years), and long (5+ years) time horizons.
4	Disclosures should be consistent over time	Disclosures should be consistent over time to enable users to understand progress of the climate-action plans, and the development and/or evolution of climate-related issues (risks and opportunities), as well as policies, regulations, and investments made to address climate change.
5	Disclosures should be comparable within a country, region, sector, industry, or portfolio	Disclosures should allow for meaningful comparisons of national and local climate investment strategies, economic and financial investment activities, risks, and performance across sovereigns.
6	Disclosures should be reliable, verifiable, and objective	Disclosures should provide high-quality reliable information and should be accurate and unbiased.
7	Disclosures should be provided on a timely basis	Information should be delivered to users or updated in a timely manner using appropriate media on, at least, an annual basis within the mainstream economy-wide reports.

A TCFD framework for sovereigns would give countries an opportunity to strengthen existing information, policies, and reporting and articulate their climate-related financial and economic risks and opportunities, help them identify investment priorities and create capital-raising plans to address climate change.

NOTES

1 Article 2.1 (c) of the Paris Agreement, https://unfccc.int/files/meetings/paris_nov_2015/application/pdf/paris_agreement_english_.pdf

2 The use of the term "sovereign" in this brief applies to local, municipal, state, and national levels of government, as appropriate to each country context.

3 See: Volz, U., et al. (2020) Climate Change and Sovereign Risk; and Beirne, J., Renzhi, N. and Volz, U. (2020) Feeling the Heat: Climate Risks and the Cost of Sovereign Borrowing. Also see: Cevik, S. and Tovar Jalles, J. (2020) This Changes Everything: Climate Shocks and Sovereign Bonds; An Apocalypse Foretold: Climate Shocks and Sovereign Defaults; and Feeling the Heat: Climate Shocks and Credit Ratings.

4 Adapted from: Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures (FINAL-TCFD-Annex-Amended-121517.pdf) https://assets.bbhub.io/company/sites/60/2020/10/FINAL-TCFD-Annex-Amended-121517.pdf.