# Recommendations of the Task Force on Climate-related Financial Disclosures – review of local relevance

## UNITED STATES

# 1. Background

Without better climate disclosure, investors face obstacles to integrating climate risks and opportunities into investment decisions. In June 2017, the industry-led Financial Stability Board Task Force on Climate-related Financial Disclosures (TCFD) released its final recommendation report for voluntary climate-related financial disclosures. The report offers eleven core recommendations in the areas of governance, strategy, risk management, and metrics and targets. It also provides supplemental recommendations for financial industries, asset owners, asset management firms, and industries accounting for the largest proportion of GHG emissions, energy usage, and water usage.

The Principles for Responsible Investment (PRI) and global law firm Baker McKenzie have together produced a series of country reviews examining how these voluntary recommendations integrate into existing regulation and soft law in specific markets, and how investors and companies in those markets can apply them. The country reviews cover the United States of America (USA), Brazil, Canada, the European Union (EU), Japan, and the United Kingdom (UK).

This review of the USA's existing regulations describes its existing climate change-related commitments (see Appendix 1), and considers existing regulation and policy on climate-related disclosure for companies and institutional investors such as pension funds.

**The PRI's response to Baker McKenzie's findings**

The PRI has 1,800 signatories in 50 countries, representing nearly US$70 trillion in assets under management. Investors have previously asked for SEC climate guidance[1], voted for climate change shareholder resolutions[2, 3] and supported the TCFD's recommendations.[4] The PRI's Fiduciary Duty in the 21st Century Roadmap for the USA[5] highlights that consistent, standardized ESG disclosures are important to implementing regulation. Baker McKenzie's analysis underpins how the TCFD will provide consistent disclosures and assist significantly in implementing existing disclosure regulation in the USA. For companies, existing regulation includes Regulation S-K, while for investors it includes the Department of Labor's Interpretive Bulletin 2016-1.

**PRI recommends three next steps:**

1. **Companies**: should adopt the TCFD's recommendations as a useful voluntary framework for consistent climate-related disclosures to investors. Sharing of company good practice will assist in overcoming implementation hurdles, with convergence in reporting frameworks needed in the longer term.
2. **Global investors**: should engage with companies to encourage adoption of the TCFD's recommendations. Investors should also evolve their disclosure to beneficiaries and clients, informed by the TCFD's guidance for asset owners and managers.
3. **Stock exchanges and G20 regulators**: should endorse the TCFD's voluntary reporting framework and update their existing guidance to reference the TCFD.

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[1] PRI, The Case for Investor Engagement in Public Policy https://www.unpri.org/download_report/3938

[2] https://www.unpri.org/news/ri-quarterly-climate-disclosure-what-does-this-years-exxonmobil-resolution-tell-us

[3] https://www.ceres.org/news-center/press-releases/exxonmobil-investors-make-history-majority-vote-climate-risk-disclosure

[4] http://investorsonclimatechange.org/wp-content/uploads/2017/05/v2-Final-Letter-to-G20.pdf

[5] https://www.unpri.org/page/fiduciary-duty-in-the-21st-century

**Action the PRI will take**

In 2017-18, PRI will support investors in:

- **Active ownership**: PRI will convene global investor engagement asking companies to adopt the TCFD recommendations. We will also collaborate with the Sustainable Stock Exchanges Initiative on voluntary disclosure guidance and encourage regulators to endorse the TCFD. PRI has produced an investor briefing on developments in US policy and regulation on responsible investment including shareholder rights.[6]
- **Investment practices and disclosure**: PRI will advance investor practices in assessment and management of material climate-related risks and opportunities. PRI will also align the 2018 PRI Reporting Framework with the TCFD's guidance for asset owners and asset managers to support good practice investor disclosure.
- **Addressing barriers around responsible investment**: the PRI has set out its priorities for the next 10 years in its Responsible Investment Blueprint, published in May 2017. Priorities include climate change, disclosure and a sustainable global financial system.

This analysis builds on the findings of the Fiduciary Duty in the 21st Century USA Roadmap developed by the PRI, UNEP FI and The Generation Foundation to overcome barriers to integrating ESG throughout the investment chain. It also draws on the regulatory analysis from PRI and MSCI's Global Guide to Responsible Investment Regulation,[7] which examined the breadth of responsible investment-related public policy initiatives across 50 economies, including the USA.

# 2. Private sector regulation

## 2.1 Disclosure requirements for companies

Federal financial disclosure requirements for U.S. public companies are regulated by the Securities and Exchange Commission ("SEC" or "Commission"). Regulation S-K[8] outlines reporting requirements for publicly held companies and also requires periodic reporting by way of forms 10-Q (quarterly filing), 10-K (annual filing) and 20-F or 40-F (for foreign companies' annual filings). Disclosing standard (i.e. non climate) environmental liabilities in these forms is not a new practice-basic requirements in respect to disclosure of environmental matters has not changed substantially since the 1980s. Currently, there is no explicit requirement for public companies to disclose impacts related to climate change in financial filings. However, the SEC, in guidance issued in 2010, has discussed how climate-related issues may pose material risks that must be disclosed under existing SEC rules.

The SEC's 2010 interpretive release, "Commission Guidance Regarding Disclosure Related to Climate Change" ("Guidance"), was issued in response to petitions from a coalition of investors, state officials, chief financial officers, and asset management firms.[9] The Guidance highlighted four areas of climate impacts to businesses that require disclosure if management determines they pose material risks under SEC rules:

- existing and pending climate legislation and/or regulation;
- international climate accords;

[6] https://www.unpri.org/about/pri-teams/policy

[7] https://www.unpri.org/page/responsible-investment-regulation

[8] 17 C.F.R. § 229.

[9] Sec. & Exch. Comm'n, Guidance Regarding Disclosure Related to Climate Change, Release Nos. 33-9106, 34-61469, 75 Fed. Reg. 6290 (Feb. 8, 2010).

- indirect consequences of regulation or businesses trends (i.e. decreased demand for goods and services that produce significant GHG emissions); and
- physical impacts of climate change (i.e. effects on business operations as a result of drought or changing weather patterns).[10]

The Guidance is consistent with the TCFD's recommendations regarding disclosure of climate-related financial risks in mainstream or public financial filings, where those risks are material for an organization. The areas noted above as relevant to climate change-related disclosures clearly have the potential to present material financial risks to certain companies. The TCFD's recommendations, particularly in the areas of metrics and targets and strategy, can help companies pinpoint what information to disclose in SEC filings. The recommendations explicitly recommend disclosure of strategy and metrics and targets "where such information is material",[11] which is well aligned with the SEC's 2010 Guidance (which itself also includes this materiality filter).

The TCFD also included within their recommendations regarding the nature of climate-related financial disclosures the consideration of a company's management of climate-related risks, i.e. its response to the risks identified in disclosures and its resilience in the face of those risks. Together with the consistent content and style of reporting proposed by the TCFD, the TCFD recommendations for disclosures are intended to promote better accounting by US companies of climate change risks, in a way that can be more effectively grasped by investors.

**TABLE 1: SUMMARY OF TCFD DISCLOSURE RECOMMENDATIONS FOR ALL INDUSTRIES**

Figure 4

**Recommendations and Supporting Recommended Disclosures**

| Governance | Strategy | Risk Management | Metrics and Targets |
|---|---|---|---|
| Disclose the organization's governance around climate-related risks and opportunities. | Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material. | Disclose how the organization identifies, assesses, and manages climate-related risks. | Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material. |
| **Recommended Disclosures** | **Recommended Disclosures** | **Recommended Disclosures** | **Recommended Disclosures** |
| a) Describe the board's oversight of climate-related risks and opportunities. | a) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term. | a) Describe the organization's processes for identifying and assessing climate-related risks. | a) Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process. |
| b) Describe management's role in assessing and managing climate-related risks and opportunities. | b) Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning. | b) Describe the organization's processes for managing climate-related risks. | b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks. |
| | c) Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario. | c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management. | c) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets. |

The extent to which a company has assessed and responded to such risks can also be important for an investor seeking to understand the company's appropriateness as a investment. The TCFD's recommendations regarding governance and risk management *do not* recommend disclosure "where such information is material", suggesting that for companies facing material climate risks that must be

[10] *Id.*

[11] TCFD Final Report, June 2017 at 14.

disclosed in SEC filings, governance and risk management issues should be disclosed *as a matter of course* under existing SEC rules, because they are already deemed material to these companies.

The Guidance also included four "Items" within Regulation S-K that showed the most potential for disclosing climate-related risk.

| Regulation S-K Item | Potential for disclosing climate-related risk |
|---|---|
| **Item 101** | This Item requires that a company must disclose any material expenditures associated with environmental controls, including costs of complying with new environmental legislation or regulations. |
| **Item 103** | This Item requires disclosure of material pending legal proceedings to which the registrant or its subsidiaries is a party, due to the immediate and future costs of litigation. |
| **Item 303** | This Item governs the more subjective area of Management Discussion and Analysis ("MD&A"). This Item requires disclosure of major trends, events, and uncertainties that could be reasonably expected to materially affect business operations. This requirement contained two separate inquiries: (1) whether an uncertainty is reasonably likely to occur; and (2) whether management can determine that an uncertainty's occurrence is not reasonably likely to have a material effect on the company. Disclosure is required unless a company is able to conclude either that it is not reasonably likely that the trend, uncertainty or other event will occur or come to fruition, or that a material effect on the company's liquidity, capital resources or results of operations is not reasonably likely to occur.[12] |
| **Item 503** | This Item requires disclosure of specific, significant factors that would make investment in a company risky or speculative. It contains regular factors included in many companies' risk management strategies: physical, financial, and reputational risks to name a few. |

In sum, the 2010 Guidance started a discussion about how to address climate risks in the Regulation S-K disclosure regime and provided some guidance to companies grappling with how to disclose climate impacts. However, while the Guidance provided greater clarity as to what information needed to be disclosed and where in it should appear under Regulation S-K, it did not explain how companies should discuss their responses to climate-related risks. Companies have taken different approaches to disclosures, which has catalysed widespread calls for the SEC to require mandatory climate risk disclosures.

**PRI Fiduciary Duty USA Roadmap**

For a complete PRI analysis of the evolving landscape of fiduciary duty in the USA market, download the Fiduciary Duty in the 21st Century USA Roadmap developed by the PRI, UNEP FI and The Generation Foundation. The roadmap builds on conversations with over thirty key market stakeholders and makes recommendations to implement clear and accountable policy and practice that embraces the modern interpretation of fiduciary duty. The project team is engaging market stakeholders to implement these recommendations. The USA roadmap is part of a larger work programme on fiduciary duty.
See www.fiduciaryduty21.org.

[12] https://www.sec.gov/rules/interp/33-8350.htm

In 2016, the SEC issued a broad Concept Release on dozens of aspects of its disclosure system, which included eight questions focused on sustainability and climate risk disclosure. The SEC asked for public comment on climate change and other environmental and sustainability disclosures. To date, the vast majority of investor comments indicate that most investors still lack adequate information about climate and sustainability risks for businesses, highlighting the need for better climate reporting guidelines from the SEC.[13]

**PRI and MSCI's Global Guide to Responsible Investment Regulation**

PRI and MSCI have developed an online global database for responsible investment regulation. For each measure, the database indicates the nature of the rule, the year of implementation, the authority responsible, whether the measure is voluntary or mandatory, and if it addresses ESG issues in isolation or in combination. To view the map and download the full methodology see https://www.unpri.org/page/responsible-investment-regulation

However, the SEC has not yet issued additional guidance in response to public comments, nor - aside from several Obama-era comment letters - has it taken any enforcement action against companies related to climate change disclosures (or lack thereof). Lacking SEC guidance, voluntary, industry-specific corporate sustainability disclosure standards like those developed by the Sustainability Accounting Standards Board ("SASB") have been used by companies that are seeking assistance in making disclosures that are material and useful for investors.

We expect no further guidance or enforcement from the SEC on climate risk disclosures in the near term. As a result, it will be important to track the market penetration of voluntary initiatives like the TCFD and SASB, to see if they become de facto disclosure standards.

## 2.2 Climate change-related aspects of pension fund/investor regulation

Corporate pension plans are regulated and enforced by the Department of Labor ("Department"), pursuant to the Employee Retirement Income Security Act of 1974 ("ERISA"). Guided by Sections 403 and 404 of ERISA, the Department has historically stated that plan fiduciaries "may not use plan assets to promote social, environmental or other public policy causes at the expense of the financial interests of the plan's participants and beneficiaries."[14] Fiduciaries may, however, consider environmental, social and governance ("ESG") goals as "tie-breakers when choosing between investment alternatives that are otherwise equal with respect to return and risk."[15] Based on Department of Labor guidance and the fact ERISA is highly litigated, fiduciaries have historically been somewhat reluctant to consider ESG factors for fear of violating ERISA's provisions.

In recognition of the confusion that prior guidance had caused and, in particular, the chilling effect of prior guidance in consideration of ESG factors, the Department issued Interpretive Bulletin 2015-01 ("2015 Bulletin").[16] The 2015 Bulletin provided guidance on the ability of pension plan fiduciaries to consider ESG factors - which includes consideration of climate change - in investment decisions. The 2015 Bulletin noted that fiduciaries should consider factors that potentially influence risk and return and that ESG factors "…may have a direct relationship to the economic value of a plan's investment."[17]

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[13] Towards a Sustainable Economy: A Review of Comments to the SEC's Disclosure Effectiveness Concept Release, September 2016 (http://www.citizen.org/documents/SustainableEconomyReport.pdf).

[14] Dept. of Labor, Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 80 Fed. Reg. 65135 (Oct. 26, 2015).

[15] *Id.* at 65136.

[16] *Id.*

[17] *Id.* at 65136.

In such case, ESG factors are proper components of the fiduciary's primary analysis of the economic merits of competing investment choices in the US. The 2015 Bulletin makes it clear that ESG factors that affect economic considerations of an investment may be considered, and are not always collateral benefits to be considered only as a tie-breaker. That said, 2015 Bulletin stated that ESG factors can continue to be used in tie-breaker situations where investment choices are otherwise equal. In addition, the 2015 Bulletin clarified that consideration of ESG factors does not require additional documentation or further evaluation by fiduciaries beyond what is generally required. The 2015 Bulletin also withdrew prior guidance (i.e. IB 2008-01) that was the source of confusion of applying ESG factors to investment decisions.

More recently, the Department of Labor issued Interpretive Bulletin 2016-1 ("2016 Bulletin")[18] addressing, among other things, proxy voting and shareholder engagement activities. In the preamble to the 2016 Bulletin, the Department noted that it was "concerned" that despite the guidance on ESG issues set forth in the 2015 Bulletin, confusion may still exist as to whether or how a plan fiduciary may consider ESG issues in connection with proxy voting or undertaking other shareholder engagement activities.

The Department makes clear that it is trying to balance thoughtful stakeholder engagement with ERISA's tight limits around fiduciaries expending assets to pursue policy preferences. The 2016 Bulletin points to the increasing numbers of institutional investor engagement on ESG issues to suggest the existence of financial benefits associated with shareholder engagement. The 2016 Bulletin further provides that a statement of investment policy can include policies "incorporating [ESG] factors in investment policy statements or integrating ESG-related tools, metrics and analyses to evaluate an investment's risk or return or choose among equivalent investments."[19] According to the 2016 Bulletin, areas in which a plan fiduciary may monitor and communicate with corporations in which the plan holds interests now include "the nature of long-term business plans including plans on climate change preparedness and sustainability".[20]

The 2015 Bulletin and 2016 Bulletin have resulted in private pension funds considering whether and how to consider ESG data in decision-making processes. The bulletins have given a boost to consideration of ESG in ERISA-regulated pension plans and also provided comfort to fiduciaries seeking to consider climate change related factors in investment decision-making. The natural extension of these bulletins is to continue the trend towards greater inclusion of ESG for both systemic risk management reasons and better analytics for sound company performance.

[18] Department of Labor, Interpretive Bulletin Relating to the Exercise of Shareholder Rights and Written Statements of Investment Policy, including Proxy Voting Policies or Guidelines, 81 Fed. Reg. 95879 (Dec. 29, 2016).

[19] *Id.* at 95883.

[20] *Id.* at 95884.

# 3. Conclusion

As the US has not yet implemented comprehensive regulations incentivizing or compelling companies to expressly consider and disclose climate change risk exposure across all sectors, adoption of a clear framework consistent with the TCFD's recommendations is likely to assist significantly in enabling companies to understand the ideal scope of their disclosures and to integrate climate risk awareness into their businesses, and their financial filings.

Such a framework would be likely to improve the quality and consistency of information available to investors. This is particularly so in relation to investors' ability to identify the more climate-resilient organizations, and organizations which are regarding the transition as an opportunity to improve their sustainability and attractiveness to investors.

In relation to pension funds and investor regulation in particular, the attempt to balance stakeholder engagement with ERISA's restrictions on fiduciaries pursuing policy preferences should not be seen as an impediment to companies implementing the TCFD's recommendations. The FSB has stated that the TCFD's recommendations are intended to apply broadly and across sectors and jurisdictions, and are not intended to supersede national regulations or encourage disclosures not in accordance with national regulations. They appear consistent with the current guidance provided to pension funds, which indicates fiduciaries should have regard to factors that potentially influence risk and return, including those ESG factors which may have a direct relationship to the economic value of a pension plan's investment.

# Appendix 1: Summary of United State's climate change commitments

Over 146 parties have ratified the Paris Agreement. Its central aim is to strengthen the global response to climate change by keeping a global temperature rise this century well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius. The goal is feasible, but only if emissions peak by 2020 at the latest. The Paris Agreement requires all parties to put forward "nationally determined contributions" (NDCs), including a requirement to report regularly on their emissions, and on their implementation efforts. In 2018, parties will take stock of the collective efforts to progress towards the goal set in the Paris Agreement.

The United States (US) ratified the Paris Agreement on 3 September 2016, and its Intended Nationally Determined Contribution that was originally submitted on 31 March 2015 formally became its NDC. Under its NDC, the United States commits to reduce greenhouse gas emissions economy-wide by 26-28 per cent below its 2005 level by 2025, and to make best efforts to reduce its emissions by 28%. However, President Trump's announcement on 1 June 2017 that the US would withdraw from the Paris Agreement, followed by the US' official communication of this decision to the UN on 4 August 2017, makes it clear that the US does not intend to implement the NDC even though it will remain officially in place until the US is permitted by the terms of the Paris Agreement to legally withdraw on 4 November 2020.

Prior to announcing its withdrawal, the US took policy actions aimed at reducing emissions by 17% below the 2005 level by 2020, through the Obama Administration's Climate Action Plan (CAP) and Clean Power Plan (CPP). Achieving the 2025 target would have required further emission reductions beyond this 2020 target of 9-11% compared to the 2005 baseline and a substantial acceleration of the annual pace of reduction, to 2.3-2.8 per cent per year, or an approximate doubling.

However, the Trump Administration's climate and energy policies , if fully implemented and not compensated by other actors (such as states and the private sector) are projected to flatten US emissions instead of them continuing on a downward trend (see the diagram below prepared by the Climate Action Tracker) and the targets in the NDC will be missed by a significant margin.

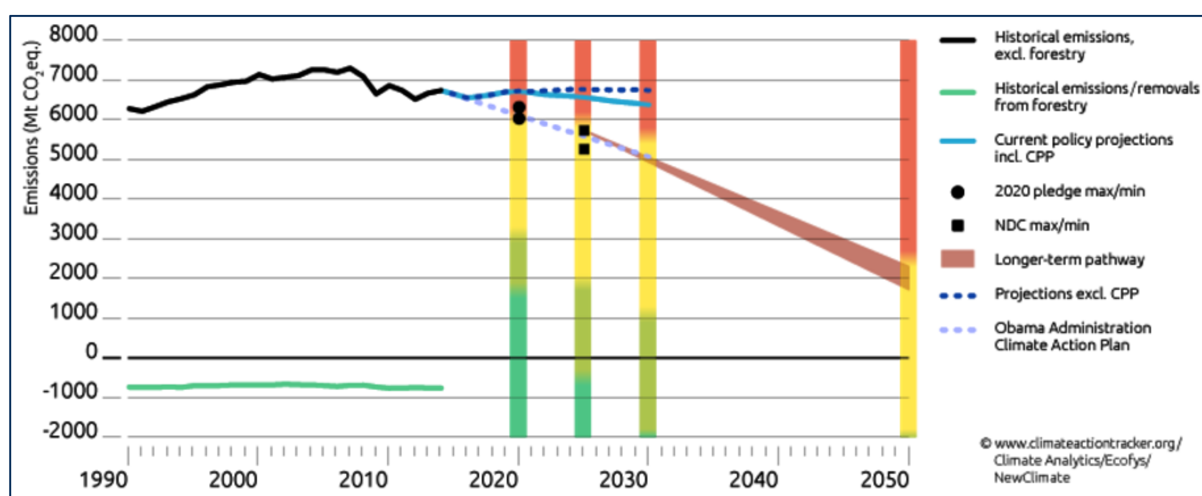


FIGURE 1. PROJECTED EMISSIONS BY THE US UNDER VARIOUS POLICY SCENARIOS[21]

[21] Climate Action Tracker, USA http://climateactiontracker.org/countries/usa.html

The Trump Administration's energy policies so far have included rescinding Obama's Climate Action Plan and taking steps towards an 'America First Energy Plan' which has in part been implemented through an executive order on 'Promoting Energy Independence and Economic Growth' (Executive Order) that demonstrates a preference for fossil fuels. The Executive Order also lifted the Obama-era moratorium on new coal mining leases on federal lands, a move which has since been challenged in courts by California, New York, New Mexico and Washington as being in breach of the federal government's statutory duties. While the CPP currently remains in place, the Executive Order calls for a review of the CPP and, if appropriate, suspension, revision, or rescinding of the CPP. Current US policies, including the CPP, are projected to reduce emissions to 10% below 2005 levels by 2025. If the CPP is rescinded, emissions in 2025 are likely to be only 7% below 2005 levels, halting the downward trend of the last decade.

Numerous US states and municipalities have responded to the action by the Trump Administration by establishing the US Climate Alliance, a bi-partisan coalition of states committed to the goal of reducing greenhouse gas emissions consistent with the goals of the Paris Agreement. It is highly likely that state-level regulation, such as emissions trading schemes and vehicle emissions limits will continue and even increase as progressive states seek to make up for the lack of federal regulation on climate change. However, it should be noted that fragmentation of policies and regulations, inconsistencies between states, and potential litigation actions against the federal government are likely to create uncertainty for businesses and investors, although many major US corporate stakeholders such as ExxonMobil, Chevron, BP, Shell and Peabody Energy have been broadly in support of the Paris Agreement.

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## About the Principles for Responsible Investment

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system. The Principles have 1,800 signatories globally, representing nearly US$70 trillion in assets under management.

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