Keywords A to Z Vol. 36

# Keyword TCFD

**Acronym for the Task Force on Climate-related Financial Disclosure. Aiming investors to make appropriate investment decisions from an ESG[*1] perspective, it makes recommendations regarding a framework for information disclosure about the financial impact of climate change.**

## Disclosure of financial climate-related information helps investors

Since the industrial revolution in the 18th century, greenhouse gases (GHG)[*2] like $CO_2$ have been increasing rapidly in the atmosphere. Climate change due to global warming is said to impact the natural environment and people's lives, and "Take urgent action to combat climate change and its impacts" is one of the 17 SDGs.[*3]

In recent years, the impact of climate change has also been emphasized in business and financial markets. This is because climate change is not only an issue for achieving a sustainable society, but also causes business losses due to natural disasters resulting from it, or causes unexpected profits due to GHG emission reduction, etc., as a result of environmental measures, laws, and regulations. From an investment and financial perspective, the financial implications of such climate-related risks are critical to the proper valuation of companies.

Therefore, in 2015, the G20 Finance Ministers and Central Bank Governors asked the Financial Stability Board (FSB), which consists of central banks and financial authorities from major countries, to discuss the disclosure of information required by investors and others. In response, the Task Force on Climate-related Financial Disclosures (TCFD) was established. It aims to encourage companies to disclose information about financial risks and opportunities related to climate change in an efficient manner that is consistent, comparable, reliable, and clear, thereby enabling investors to make appropriate investment decisions.

## TCFD presents a framework for disclosing information

In 2017, the TCFD published a final report summarizing recommendations on how companies should voluntarily disclose information. It presented four basic items that are recommended to be disclosed in climate-related information: governance, strategy, risk management, and metrics and targets. *Governance* relates to disclosure about the oversight structure of the board of directors and the role of management in assessing and managing climate-related risks and opportunities. *Strategy* involves the impact of climate change risks and opportunities on business, strategy, and finances. *Risk management* describes the processes for identifying, assessing, and managing risks associated with climate change. *Metrics and targets* aim to clarify the indicators used for assessing and managing risks and opportunities associated with climate change, and the KPIs[*4] and targets that will be set to carry them out. If we take GHG emissions as an example, a company would need to tell how indicators related to emission intensity[*5] are established and what the company's reduction targets and target periods are.

The risks mentioned here include not only risks like natural disasters that are directly caused by climate change, but also risks associated with policies related to climate change, such as the tightening of tax systems and regulations to combat global warming. On the other hand, for companies with environment-related businesses, efforts to combat global warming may create new business opportunities.

The TCFD's report format presents a method for comprehensively understanding the risks and opportunities of climate change, analyzing the financial impact, and annually disclosing it as financial information.

## Related initiatives are accelerating around the world

In response to these TCFD recommendations, countries are accelerating efforts to disclose information on climate change. In the UK, companies listed on the London Stock Exchange Premium Market are required to disclose information in line with the TCFD recommendations. The U.S. Securities and Exchange Commission is also reviewing its current rules regarding disclosure of climate change risks to comply with international disclosure standards.

©ad-manga.com

In Japan, the Tokyo Stock Exchange revised the Corporate Governance Code, which is the code of conduct for listed companies, in 2021. In the exchange's prime market, which has the most stringent listing criteria, companies are now required to collect and analyze data on the impact of climate change–related risks and opportunities on business activities and earnings, and to use the TCFD's framework or an international equivalent. The Financial Services Agency is also considering disclosure of information on such risks in securities reports submitted by listed and some unlisted companies.

As the inevitability of investment based on ESG perspectives is emphasized, the movement to request disclosure of information on the financial impact of climate change is gaining momentum. For companies, demonstrating their support for the TCFD recommendations not only serves to advertise ESG-focused management, but also allows companies to deepen their understanding of their own climate-related risks and opportunities and develop strategies to prepare for future uncertainties. In addition, because measures against climate change will also help to achieve the SDGs, the number of participating companies is expected to increase in the future.

*1 ESG
ESG stands for environmental, social, and governance. It expresses the idea that environmental, social, and governance concerns are necessary for the sustainable growth of society and of companies.

*2 Greenhouse gas (GHG)
A general term for gases in the atmosphere that cause a "greenhouse effect" by absorbing part of the infrared radiation emitted from the surface.

*3 Sustainable Development Goals
The SDGs were incorporated into the 2030 Agenda for Sustainable Development, which was adopted unanimously by member states at a United Nations Summit in September 2015. 17 goals and 169 targets were established in order to achieve a sustainable, diverse, and inclusive society where no one will be left behind.

*4 Key Performance Indicator (KPI)
An important indicator for evaluating performance. KPIs reflect the progress towards achieving the goals of the organization.

*5 Emission intensity
Amount of GHGs, such as $CO_2$, emitted per unit of activity


**Azbil Corporation**
www.azbil.com

This article was published in April 2023.