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Russell Picot
Special Advisor, Task Force on Climate-related Financial Disclosures
c/o PWC

By email to: tcfd2017@uk.pwc.com

9th February 2017

Dear Task Force Members,

Response to consultation on proposals of FSB Task Force on Climate-related Financial Disclosures

Hermes Investment Management is an asset manager with approximately £28 billion of assets under management and focused on delivering superior, sustainable, risk adjusted returns to its clients – responsibly. Hermes' stewardship team, Hermes Equity Ownership Services (EOS), provides stewardship services, including corporate engagement and voting recommendations for around 40 international pension funds with assets of approximately £235 billion[1].

As part of our Equity Ownership Service (Hermes EOS), we respond to consultations on behalf of many clients from across the UK and around the world, including PNO Media (Netherlands), VicSuper of Australia, DIP/JOP and MP Investment Management A/S of Denmark and the BBC Pension Trust (only those clients which have expressly given their support to this response are listed here).

Executive summary

Hermes EOS, on behalf of its clients, broadly welcomes the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), both as they apply to companies and to key segments of the financial system (banks, insurance, asset owners and asset managers). Our key messages are as follows:

- We strongly support the focus on forward-looking risk analysis and reporting, rather than increased reporting of historical data, together with the use of scenarios as an appropriate tool by which to achieve this; the emphasis on reporting climate-risks in financial disclosures to make clear the link to finance and its materiality; and sector-specific guidelines which differentiate levels of materiality of climate risks and recommend different metrics and reporting approaches.
- We support the goal of the Task Force to achieve more quantified appraisals of climate-risk materiality in addition to qualitative appraisals, particularly for high risk sectors such as Energy. However, we propose that the Task Force tightens its recommendation on this beyond the level of 'consider' to a 'comply or explain' guideline. We believe there is a risk that the current Task Force guidelines legitimise the view it is not necessary to quantify risks that are perceived to be low materiality without giving a good rationale for this conclusion, particularly where the scenarios are explicitly advised, such as for the Energy sector.
- We support the guidelines for asset owners and asset managers. Our interpretation of the guidelines is that the use of scenarios is likely to be a useful tool in analysing climate-related risks and opportunities. However, there is not a recommendation or requirement to use scenario analysis comprehensively across all elements of a portfolio, or on all investment products or investment strategies. This enables scenarios to be used in a more targeted way

[1] Assets under management and under advice correct as at 30 September 2016

in areas of higher risk. In addition, given the anticipated overhead in generating and applying climate scenarios to investments, many smaller asset owners or managers are likely to need to delay detailed scenario analysis until the development of more standardised tools and guidance on potential materiality.

- We cautiously support the guidance for Asset Owners and Managers to report GHG emissions normalised for every million of the reporting currency invested. Given the limited value of GHG emission reporting in appraising risks, it is likely to be disproportionate to report against this metric for those parts of a fund where there is not readily available data. As more risk tools develop, alternative and more efficient metrics may also develop that supersede this metric. The ability of asset owners and managers to report on climate-related risks is limited by the quality of such reporting by companies and therefore an improvement in corporate reporting is a pre-requisite to good quality asset manager and owner reporting.
- Our principle concern is that companies and investors will use different climate scenarios and analytical approaches which lead to difficulty in comparing disclosures even within the same sector. Over time, the development of standardised scenarios containing the necessary data and assumptions for sector-based analysis should be developed which will help resolve this lack of comparability and reduce costs.
- We make some specific recommendations on improvements to the sector guidelines for reporting, including around increased reporting on board expertise to understand and appraise climate-related risks, as well as the disclosure of the public policy position on climate change and governance over its implementation to ensure consistency when lobbying companies.
- Overall, we believe the Task Force recommendations are a good foundation for improved reporting. However, a period of innovation in climate-risk reporting is anticipated and frequent updates on guidelines are likely to be required in order to keep the recommendations up to date guidelines on latest best practice. There is therefore an ongoing role for the Task Force in maintaining and updating best practices.

The consultation requires a response to pre-set questions using a web-based template. In the appendix we set out our more detailed response to each question in blue font and this will be copied and pasted into the required web-based template before the deadline on 12th February.

If this response provokes any questions, please do not hesitate to get in contact with me using the details below.

Yours sincerely,

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Appendix

Response to consultation questions for input to required web-based template

Welcome to the Task Force on Climate-related Financial Disclosures (TCFD) report consultation. The purpose of this consultation is to get your views on recommendations in the Task Force's report. Your comments will assist the Task Force in finalizing the report scheduled to be released in mid-2017. We are eager to hear your views, and your contribution to this important research is appreciated.
The consultation is designed to take around 10-20 minutes to complete. We would appreciate receiving your responses before February 12, 2017.

All responses will be treated as confidential. While the Task Force may release a summary of comments received, none of the comments you make or opinions you express will be attributed to you personally without your express permission. The survey is administered by PwC's Research to Insight (r2i) team, which operates under the Code of Conduct of the Market Research Society ensuring complete independence and confidentiality.

If you have any questions about the survey process, please send them to tcfd2017@uk.pwc.co.uk
Respondent Information
Q1a Please provide your information in the boxes below:

Mr Bruce Duguid, Hermes Equity Ownership Services, Director, United Kingdom.

Q1b Which of the following best describes your area of responsibility in your organization?
Please select ONE only

Finance

Q1c Which of the following best describes your organization type?
Please select ONE only

Financial Services Sector, including asset owners

Q1d [ONLY ASK IF CODE 1 OR 5 AT Q1c] Please select your primary industry from the list below:
Please select ONE only

Asset management

Q2 ASK ALL: Which of the following best describes your perspective on the TCFD recommendations?
Please select ONE only

Both a user and preparer of climate-related financial disclosures

All Sector Recommendations and Guidance
The Task Force structured its recommendations around four thematic areas that represent core elements of how organizations operate: governance, strategy, risk management, and metrics and targets (see page 16 of the TCFD report). The Task Force believes it is important to understand the financial and strategic implications associated with climate-related risks and opportunities on organizations as well as the governance and risk management context in which organizations operate

Q3a How useful are the Task Force's recommendations and guidance for all sectors in preparing disclosures about the potential financial impacts of climate-related risks and opportunities?

Very useful – [5/5]

Q3b Please provide more detail on your response in the box below

We strongly support the focus on forward-looking risk analysis and reporting, rather than increased reporting of historical data, together with the use of scenarios as an appropriate tool by which to achieve this; the emphasis on reporting climate-risks in financial disclosures to make clear the link to finance and its materiality; and sector-specific guidelines which differentiate levels of materiality of climate risks and recommend different metrics and reporting approaches.

Supplemental Guidance
Q3c How useful is the Task Force's supplemental guidance for certain sectors in preparing disclosures about the potential financial impacts of climate-related risks and opportunities? Please see the TCFD Annex for supplemental guidance.

Very useful – [5/5]

Q3d Please provide more detail on your response in the box below

We support the sector-specific guidance. This is a useful framework and we believe its content will likely evolve over time and improve further as better practices develop.

Organizational Decision Making
Q4a If organizations disclose the recommended information (or information consistent with the Task Force's recommendations), how useful will that information be to your organization in making decisions (e.g., investment, lending, and insurance underwriting decisions)?

Quite useful – [4/5]

Q4b Please provide more detail on your response in the box below

Generally, the information provided by companies to investors will allow investors to better appraise the level of climate risk that the organisation bears. The quality of the reply will also give an insight into the level of management capability to assess such issues, as we would expect detailed replies on future risks from those companies that have properly appraised such risks. We believe today's framework is a useful foundation for reporting. However, climate risk management practices are likely to evolve and improve and therefore the initial reporting is likely to be somewhat less useful than the long-term potential of the guidelines.

Additional Disclosures
Q5 What other climate-related financial disclosures would you find useful that are not currently included in the Task Force's recommendations?

We believe the guidelines should include disclosure of the public policy positon of companies on climate change, as investors and companies may have the ability to slow the adoption of necessary climate policy through lobbying and other public relations activity. This could result in increased systemic financial risk resulting from climate change.

Scenario Analysis
ASK ALL
Q6 The Task Force recommends organizations describe how their strategies are likely to perform under various climate-related scenarios, including a 2°C scenario (see page 16 of the TCFD report). How useful is a description of potential performance across a range of scenarios to understanding climate-related impacts on an organization's businesses, strategy, and financial planning?
Please select ONE only

Very useful – [5/5]

Q7 Please elaborate on your response above. If you selected "Not very useful" or "Not useful at all" please indicate what would be more useful.

One of the most important anticipated benefits of the Task Force recommendations is to focus on forward-looking risk analysis using scenarios, rather than mere reporting of historical data. Given the uncertainty in terms of climate change outcome (policy measures, technological innovation, consumer behaviours and the overall pace of change), a scenario-based approach is likely a very useful tool by which to analyse future risks and help identify potential mitigating actions.

Q8 The Task Force recognizes that there are challenges around disclosing sufficient information to allow a better understanding of the robustness of an organization's strategy and financial plans under different plausible climate-related scenarios. Some challenges may arise from unfamiliarity with scenario methodologies and metrics, insufficient practice standards or cost. What do you view as effective measures to address potential challenges around conducting scenario analysis and disclosing the recommended information?
Please rank your top three most effective factors that apply.

Further work by industry trade groups and disclosure users on critical elements to be disclosed is needed to help overcome concerns that some information may be commercially sensitive	3
Reduce the cost of conducting and disclosing scenario analysis	
Additional methodologies and tools should be developed for use by organizations to enable more effective scenario analysis	1
Allow a year or two to phase-in scenario analysis and related disclosures	
Establish better practice standards around conducting and disclosing scenario analyses so that there are clearer rules of the road	2
We do not anticipate any difficulties	
Other (please specify)	
Not applicable	

Q9 Please provide more detail on your first choice in the box below

Our principle concern is that companies and investors will use different climate scenarios and analytical approaches which lead to difficulty in comparing disclosures even within the same sector. Over time, the development of standardised scenarios containing the necessary data and assumptions for sector-based analysis should be developed which will help resolve this lack of comparability and reduce costs. In addition, many companies cite commercial confidentiality as a reason to not report in any detail methodologies and results of forward-looking risk analysis. We feel that this is surmountable, as already some companies are providing detail that other companies claim is commercially sensitive. However, it is a barrier that needs to be overcome through industry guidance, best practice by companies and the encouragement of the Task Force and the users of reporting.

Q10a The Task Force is recommending that organizations disclose the metrics they use to assess climate-related risks and opportunities in line with their strategy and risk management process. For certain sectors, the report provides some illustrative examples of metrics to help

organizations consider the types of metrics they might want to consider. How useful are the illustrative examples of metrics and targets?
For illustrative examples see the following pages in the TCFD Annex
☐ Energy Group: pages 54-58
☐ Transportation Group: pages 66-70
☐ Materials and Buildings Group: pages 78-82
☐ Agriculture, Food, and Forest Products Group: pages 91-94

Quite useful – [4/5]

Q10b Please provide more detail on your response in the box below

The list of metrics and targets looks reasonably comprehensive, subject to a couple of additions below. We expect that over time best practice will build on this to improve reporting and further updates on guidelines will be required. Additional guidance should be included on the following:

- Board expertise: the guidance on governance reporting should include an explanation of the board's own assessment of skills and experience in understanding climate-related risks and how it obtains the necessary input, if necessary using independent external advice.
- Governance of public policy: it is important for companies to explain their public policy position on climate change and how they govern the risk that its on-the-ground lobbying, whether conducted directly or via third parties including trade associations, may be inconsistent with this publicly-stated position. This is relevant to financial risk as poor public policy introduces the systemic risk of not constraining climate change to safe levels. In particular, they should disclose what their escalation process is when the position of a third party funded by the company contradicts its own policy position.
- Opportunities – overall, the recommendations focus more on risk than opportunity. While this is understandable, they should also acknowledge that there could also be opportunities. It is important that these are separately reported, rather than only reported in aggregate or 'netted off' without transparency of the nature and magnitude of each of the major heads of risk and each of the major opportunities.

We also have the following additions to consider:

- Energy & Materials: in addition to giving guidance on revenues, it is important to publish the assumptions in a scenario on commodity prices. A potential flaw of scenario planning work is to conduct detailed analysis of potential demand over time, but not carry out corresponding analysis on the levels of supply or to determine the implications for price of commodities, which ultimately drives assumptions on revenues and profitability.
- Materials: include the metric suggested for oil & gas industry for the materials industry in respect of reporting on expenditure and capital including: "Indicative costs of supply for current and committed future projects (e.g., through a cost curve or indicative price range). This could be broken down by product, asset, or geography."
- Transportation: an important scenario assumption to reference is the level of roll-out of charging infrastructure for electric vehicles and who might bear its cost.
- Insurance companies: further guidance is required to request disclosure of the insurers view on how actuarial models based on historic performance might be affected by the unprecedented changes that may accompany different types of climate-related risks and the business consequences of any such changes.

Q11 Part of the Task Force's remit is to develop climate-related disclosures that would enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector.

Beyond the metrics included in the Task Force's guidance, and supplemental guidance, what other metrics could be used to measure carbon-related assets in the financial sector?

We cautiously support the guidance for asset owners and managers to report GHG emissions normalised for every million of the reporting currency invested. However, we agree with the note which accompanies this recommendation that there are significant limitations to this metric and we look forward to a period of innovation in best practice which yields better risk metrics over time. The ability of asset owners and managers to report on climate-related risks is limited by the quality of such reporting by companies and therefore an improvement in corporate reporting is a pre-requisite to good quality asset manager and owner reporting.

Q12 Please describe your views on the feasibility of implementing the above recommendation

Given the limited value of GHG emission reporting in appraising risks, it is likely to be disproportionate to report against this metric for those parts of a fund where there is not readily available data. As more risk tools develop, alternative and more efficient metrics may also develop that supersede this metric.

Greenhouse Gas Emissions (GHG) Associated with Investments
IF CODE 1 AT Q2 ASK Q13a AND 13b OTHERWISE GO TO Q14
Q13a How useful would the disclosure of GHG emissions associated with investments be for economic decision-making purposes (e.g., investing decisions)?
Please select ONE only

Neither/ nor – [3/5]

Q13b Please provide more detail on your response in the box below

GHG footprinting of investments is just one input into appraising climate-related risks and must normally be accompanied by other risk appraisal tools in order to make a balanced appraisal of climate-related risks. Accordingly, while such data is useful, it must be used with caution.

Remuneration
ASK ALL
Q14 Which types of organizations should describe how performance and remuneration take climate-related issues into consideration?

The Energy Group as recommended by the Task Force – 1.

Q15 What do you view as the potential difficulties to implementing the disclosures?
Please select ALL that apply

- The information requested could be commercially sensitive
- The time and cost of collecting the information
- Lack of experience with concepts and methodology

Q16 What, drivers if any, do you think would encourage you to adopt the recommendations?
Please select ALL that apply

- Requests from clients or beneficiaries
- Reputational benefits and goodwill from adoption
- Adoption by industry peers

Q17 What support or actions would be helpful to you in implementing the disclosures within the next two years?

Industry guidance on best practices by which to report climate-related financial risks, together with more standardised and accessible public scenarios, tailored to be used by the asset owner and management industry.

Q18 The Task Force's recommendations are focused on disclosure in financial filings; within what timeframe would your organization be willing to implement the recommendations in financial filings?
Please select ONE only
In the next one to two years

Additional Feedback
ASK ALL
Q19 What additional feedback you would like to provide the Task Force on the recommendations?

We support the goal of the Task Force to achieve more quantified appraisals of climate-risk materiality in addition to qualitative appraisals, particularly for high risk sectors such as energy. However, we propose that the Task Force tightens its recommendation on this beyond the level of 'consider' to a 'comply [disclose] or explain' guideline. We believe there is a risk that the current Task Force guidelines legitimise the view it is not necessary to quantify risks that are perceived to be low materiality without giving a good rationale for this conclusion, particularly where the scenarios are explicitly advised, such as for the Energy sector.

Overall, we believe the Task Force recommendations are a good foundation for improved reporting. However, a period of innovation in climate-risk reporting is anticipated and frequent updates on guidelines are likely to be required in order to keep the recommendations up to date guidelines on latest best practice. There is therefore an ongoing role for the Task Force in maintaining and updating best practices.

Below is some background to Hermes and who this response represents.

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