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Agnieszka Cochrane is an ESG specialist at Fidante, and has extensive experience working with boutique investment teams and their clients. Her strong relationships and knowledge of their investment processes make her well placed to understand their ESG beliefs and goals, and to identify areas for continuous progress in integration. Prior to Fidante, Agnieszka worked in London at Newton Investment Management and at BNY Mellon, both leading firms in ESG integration. Agnieszka has a BSc. (Hons) from University College London (UCL), IMC from the CFA Society (UK) and is a Chartered Investment Management Analyst (CIMA).

# The TCFD framework

## What is it and how can it be applied to investment analysis?

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### The TCFD framework:

Understanding how climate change may affect the intrinsic value of a company is quickly evolving. Until recently, analysis focused on the impact of a company's operations on the environment. This has shifted to an assessment of a company's exposure to extreme weather events as well as exposure to economic and policy changes associated with a transition to a low-carbon economy.

The recommendations by the Task Force for Climate Related Financial Disclosures (TCFD) provide a framework for companies to assess climate-related financial impacts on their business in a way that is comparable and consistent across the market.

Widespread adoption of this framework could be the first step in enabling portfolio managers and analysts to systematically incorporate climate change considerations into investment analysis (see Figure 1 on the next page of this paper).

### What are the TCFD recommendations?

The TCFD framework is a market-driven initiative, set up to develop a set of recommendations for voluntary and consistent climate-related financial risk disclosures in mainstream filings. *Responsible Investor* reported that the UK's government and financial regulators have announced plans to make TCFD reporting mandatory. The UK will be the first country to implement this.

The TCFD framework centres around four themes that represent core elements of how organisations operate, namely:

- governance
- strategy
- risk management
- and metrics and targets.

To understand how the TCFD framework translates to corporate behaviour is to understand the key questions corporations would need to ask themselves as part of TCFD analysis. These questions are summarised in Table 1 on the final page of this paper.

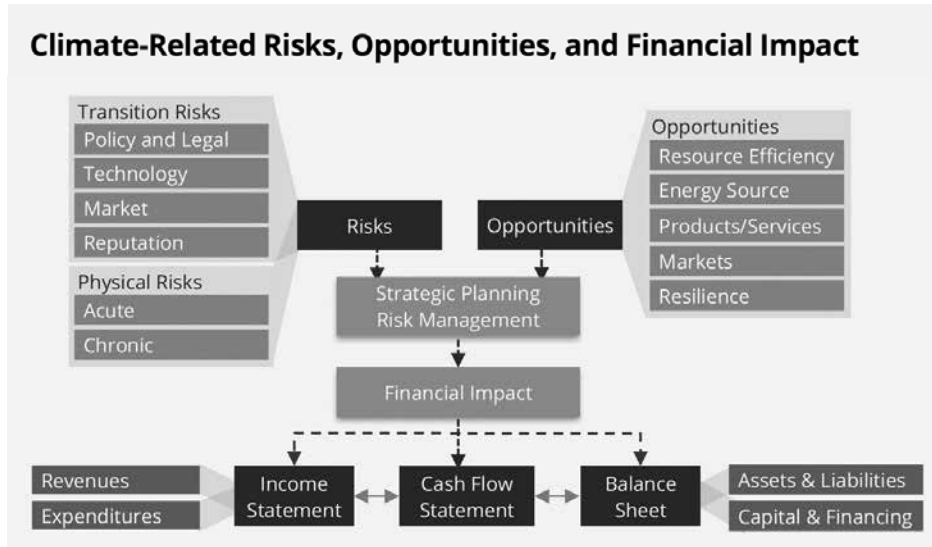
### The TCFD approach in investment analysis

The TCFD approach can also be utilised by investment managers when assessing investment risks and opportunities, even in the absence of widespread TCFD reporting by companies.

Understanding board oversight, risks and opportunities, impacts, resilience and metrics around climate change for each investee company can provide insights into how exposed a company is to climate change-related physical and transition risks. Engaging companies on their disclosure of this information and on the gaps in their climate risk management can increase company value long term. Investee companies reporting under the TCFD framework are likely to improve market efficiency and gain better risk analysis in the future. Although in its infancy, we expect to see this information disclosure becoming part of standard company financial reporting, particularly if TCFD reporting becomes compulsory.

The availability of scenario analysis tools is increasing. ESG data providers are developing new climate transition metrics that look at

Figure 1. TCFD framework for reporting climate-related financial disclosures



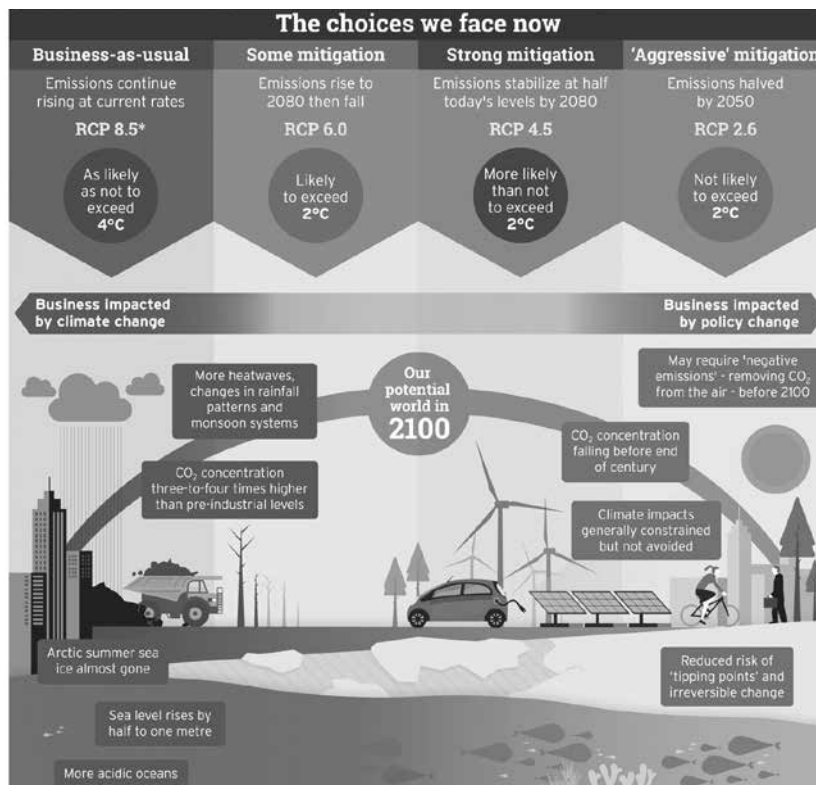
Source: The Financial Stability Board Task Force on Climate-related Financial Disclosures (TCFD)



**The quote**

*The UK's government and financial regulators have announced plans to make TCFD reporting mandatory.*

Figure 2. Carbon crossroads: The Intergovernmental Panel on Climate Change (IPCC) explores four potential futures depending what policies governments adopt to cut emissions



Source: Infographic produced by Cambridge Institute for Sustainability Leadership (CISL) at Cambridge University and the Climate Reality Project based on work done by the Intergovernmental Panel on Climate Change (IPCC) as part of the Fifth Assessment Report (AR5)

**Table: 1. Key questions for corporations**

Governance	
Board Oversight and Management	<ul style="list-style-type: none"> <li>Does the board have oversight of climate related risks and opportunities?</li> <li>What is the process and frequency by which the board or board committees are informed about climate related issues?</li> <li>Are climate related issues considered when reviewing and guiding strategy, risk management policies and setting the organisation's performance objectives?</li> </ul>
Strategy	
Risks and Opportunities	<ul style="list-style-type: none"> <li>What are the risks and opportunities arising from the company's transition to a low carbon economy in the short-, medium- and long-term (policy and legal, technology, market and reputational)?</li> <li>What are the risks and opportunities for the company from the physical impacts of climate change (chronic and acute) in the short-, medium- and long-term (including the company's supply chains, assets and infrastructure)?</li> <li>What are the company's current and potential future scope 1 and 2 carbon emissions?</li> </ul>
Impacts	<ul style="list-style-type: none"> <li>What is the impact of identified climate-related issues on the company's businesses and strategy in the following areas? <ul style="list-style-type: none"> <li>Products and services</li> <li>Supply chain and/or value chain</li> <li>Adaptation and mitigation activities</li> <li>Investment in research and development</li> </ul> </li> <li>Operations (including types of operations and location of facilities)</li> <li>What is the impact of identified climate-related issues on financial planning in the following areas? <ul style="list-style-type: none"> <li>Operating costs and revenues</li> <li>Capital expenditures and capital allocation</li> <li>Acquisitions or divestments</li> <li>Access to capital</li> </ul> </li> <li>Has the company performed a climate change-related scenario analysis or stress test? If so, does it apply to the whole business or a portion? Which scenarios were used?</li> </ul>
Additional Guidance for Asset Managers	<ul style="list-style-type: none"> <li>How are climate-related risks and opportunities factored into relevant products or investment strategies?</li> <li>How might each product or investment strategy be affected by the transition to a lower-carbon economy?</li> </ul>
Resilience	<ul style="list-style-type: none"> <li>How resilient is the company's strategy to climate change-related transition and physical risks and opportunities?</li> <li>How might their strategies change to address such potential risks and opportunities?</li> <li>What would the cost of such a change be to the company?</li> </ul>
Risk Management	
Identification, Management and Integration	<ul style="list-style-type: none"> <li>What are the risk management processes for identifying and assessing climate-related risks?</li> <li>What are the processes for managing climate related risks?</li> <li>How does the company decide whether to mitigate, transfer, accept, or control those risks?</li> <li>How are these processes integrated into their overall risk management?</li> </ul>
Additional Guidance for Asset Managers	<ul style="list-style-type: none"> <li>Describe engagement activity with investee companies to encourage better disclosure and practices related to climate-related risks</li> <li>How are material climate-related risks identified, assessed and managed for each product or investment strategy</li> <li>How might each product or investment strategy be affected by the transition to a over-carbon economy</li> </ul>
Metrics and Targets	
Key Metrics, GHG Emissions and Targets	<ul style="list-style-type: none"> <li>What are the key metrics used to measure and manage climate-related risks and opportunities?</li> <li>What are the company's Scope 1, 2, and, if appropriate Scope 3, emissions? How have these changed over time?</li> <li>Does the company have climate-related targets related to GHG emissions, water usage, energy usage, etc., in line with anticipated regulatory requirements or market constraints or other goals. What are the methodologies used to arrive at these targets?</li> </ul>
Additional Guidance for Asset Managers	<ul style="list-style-type: none"> <li>What metrics are used to assess climate-related risks and opportunities in each product or investment strategy and how have these changed over time?</li> <li>What is the weighted average carbon intensity for each product or investment strategy?</li> </ul>

Source: © Fidante Partners

whether companies and portfolios are aligned with the Paris Agreement's 2-degree goals, as well as calculating climate change-related value-at-risk for both listed and unlisted assets. Also, several ESG data providers have been strengthening their climate risk assessment capabilities with acquisitions of specialist climate solutions firms in preparation for a rise in demand for TCFD reporting.

### Scenario analysis

One of the key components of the TCFD framework is scenario analysis. This stress test enables companies to assess the resilience of their business under different economic and policy responses to the climate crisis.

It is important to remember that there is no one 'worst case scenario' when it comes to the impacts of climate change on businesses. A rapid policy response could lead to the demise of companies that cannot adapt quickly, whereas physical climate impacts could wipe out the value of exposed assets and industries.

The aim of scenario analysis in this context, is to help companies identify their value-at-risk should such scenarios materialise.

If climate-related financial disclosure became part of annual financial statements, as the TCFD recommends, investment managers would be able to integrate climate-related risks into their investment analysis with much more confidence (see Figure 2 on the preceding page of this paper).

Climate risk integration frameworks can provide a basis for investment managers to develop their own approach. As the data increases, investment managers will be able to identify which companies are improving and which are not. It is this momentum which could serve as a new source of alpha. Increasingly, as asset managers understand climate-related risks associated with the companies they invest in, these risks will be factored into asset valuations. By engaging with these companies and increasing transparency, climate-related considerations can be integrated into investment analysis. **FS**

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