Climate risk
A guide to support robust climate risk disclosures
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Climate risks play an ever-increasing role in our modern-day economy. With climate change happening faster than anticipated (as shown in the recent IPCC report\(^1\) and recognised in the COP26 discussions) and already impacting our planet, society and the economy, it is clearly a material societal and business issue. Organisations must therefore urgently address and disclose their climate risks, both to mitigate the alarming effects of climate change and to become more climate-resilient. Moreover, transparency regarding climate risk exposures and opportunities is essential for responsible investment decisions.

Why now is the time to act?

1. Climate science shows us the risks are real and urgent action is required.
2. The EU Taxonomy and CSRD apply to a large group of organisations and require them to understand, integrate and report on climate risk.
3. The draft EFRAG climate standard and the draft IFRS climate related disclosure prototypes show us a glimpse of the upcoming sustainability reporting requirements for climate - a lot more is expected than currently reported by most organisations.

Climate risk disclosures - what is happening?

The global landscape on climate risk disclosures is evolving. Recent developments reflect increased momentum with the G7 finance ministers and several central bank governors, stating their support for mandatory climate risk disclosure in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD)\(^2\). The U.S. Securities and Exchange Commission (SEC) is contemplating to mandate climate risk disclosures as well. In a number of jurisdictions such as Switzerland, France, New Zealand, and the UK, climate reporting is already mandatory or will soon become mandatory.

In Europe, sustainability disclosures are being standardised to support investment decisions. The European Commission published a proposal in April 2021 for a Corporate Sustainability Reporting Directive (CSRD)\(^3\). This proposal will revise the sustainability reporting requirements in order to make them more consistent with the broader sustainable finance legal framework, including the Sustainable Finance Disclosure Regulation (SFDR)\(^4\) and the EU Taxonomy Regulation\(^5\). Furthermore, the European Financial Reporting Advisory Group (EFRAG) which is facilitating the standard-setting process has indicated that they will build on international frameworks, including TCFD. EFRAG’s first prototype on climate risk reporting\(^6\), aimed to lay the grounds for the draft climate standard. It summarises the alignment with other frameworks along different disclosure areas related to strategy, implementation and performance measurement. In addition, the European Banking Authority (EBA) published the consultation on draft technical standards on Pillar 3 disclosures of ESG risks in May 2021, providing a disclosure framework for, amongst others, climate risk for financial institutions\(^7\). This framework was built on the TCFD recommendations, as was the ECB Guide on climate-related and environmental risks\(^8\), requiring banks to disclose their climate risks and integrate them into their risk management approach. The recently announced IFRS prototype climate related disclosure requirements developed for the newly-formed International Sustainability Standards Board (ISSB) also build on the TCFD recommendations\(^9\).

These developments stress the importance of sound climate risk disclosures. Although the TCFD itself is not mandatory in Europe, its framework can be seen as a strategic risk management framework for climate risk and can feed into sustainability disclosures. Most importantly, it can be used as a tool to understand and integrate climate risk and opportunities into business processes.

Organisations play a central role in ensuring that the climate risk disclosures represent a fair, balanced and comprehensive assessment of progress, and that the impact of climate change has been adequately reflected on in the financial statements.

The time to act is now.
What is TCFD?
The TCFD recommendations address governance, strategy, risk management, and metrics and targets.

Governance: governance around climate-related risks and opportunities.
Strategy: actual and potential impacts of climate-related risks and opportunities on the organisation’s businesses, strategy, and financial planning where such information is material.
Risk management: how the organisation identifies, assesses, and manages climate-related risks.
Metrics and targets: metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.

For the EU Taxonomy, organisations need to screen their economic activities on the contribution to climate change mitigation and climate change adaptation. This will result in a need for risk and vulnerability assessments providing insights in the physical climate risks and ways to reduce those.

The value of assurance to support climate risk disclosures
Auditors play a key role in the flow of reliable information for decision-making, which may include climate-related impacts on financial reporting. Third party assurance can enhance the reliability of climate-related information:

• Supporting audit committees: assurance enables audit committees to assess the quality of climate risk disclosures. Also, it provides a mechanism to improve and establish market confidence in these disclosures.

• Supporting stakeholder engagement and confidence: investors, regulators, customers and employees are increasingly making decisions that factor in climate-related pledges. Climate risk assurance provides a clear message of intent, commitment and confidence to these stakeholders.

• Enhancing strategic and competitive considerations: in a marketplace inundated with unchecked environmental, social and governance (“ESG”) claims and “greenwashing”, climate risk assurance can provide differentiation by means of credibility and confidence.

Assurance on specific climate risk disclosures is currently not required in the Netherlands. However, limited assurance is foreseen to be part of the CSRD transition. Financial teams and audit committees should consider the level of assurance their stakeholders expect. For example, reasonable assurance may be preferred for those KPIs tracked for remuneration purposes. In addition, organisations should begin their preparations regarding the EU Taxonomy and CSRD.
Questions for board members supporting the journey towards robust climate risk disclosures

- Is there a basic level of understanding of the most material climate-related risks affecting the organisation, including its own operations, its loan or investment portfolios and extended supply chain?
- Has organisational purpose and strategic focus been integrated into the reporting framework and are climate change issues considered in the overall strategy, KPIs, targets, the financial performance, product development and business plans?
- Has scenario analysis been performed to analyse the impact of climate change under different potential futures?
- Are risk and control (second line) and internal audit (third line) involved in the climate risk management process?
- Is the climate risk data reliable and fit for purpose, and is it produced with the same rigour as financial information, including a clear process to ensure quality?
- Has the organisation undertaken a gap analysis of current versus required climate risk disclosures relevant to peers and context; is there a plan in place to remediate any gaps?
- Have the financial statement elements been verified against climate-related topics?
- How could independent reviews support the robustness of climate risk disclosures and the adequacy of systems and controls? What assurance is required?

Climate risk and remuneration policies

Investors are increasingly considering climate risks in the context of remuneration. Examples of these considerations are: is the management of an organisation sufficiently stimulated to look at the medium- and long-term risk mitigation strategy, including the impact of their own behaviour, to meet the climate targets set within their organisation? In the banking sector the ECB Guide is clear that banks are expected to ensure that their remuneration policy and practices stimulate behaviour that is consistent with their climate risk approach.

A recent trend is the use of sustainability targets in bonus or long-term incentive plans. In the Netherlands this is underpinned by the Shareholder Rights Directive (SRD), requiring of listed organisations to explain how the remuneration of their directors contributes to the organisation’s strategy, its long-term interests, and its sustainability. Linking climate risk with rewards is therefore not only an opportunity to focus performance attention on climate adaptation, but is in fact a requirement for most organisations.

What can organisations do now?
Organisations can start today in taking first steps towards robust climate risk disclosures:

1. Baseline assessment

A baseline assessment comprises of a qualitative climate risks assessment and benchmarking with industry peers, and interviews with key internal stakeholders. Suitable best practices in climate risk reporting are identified.

2. Define governance

Relevant management support and leveraging existing initiatives helps to define appropriate governance for the organisation. An optimal structure and clear accountabilities for climate risk oversight and reporting responsibilities are set out.

3. Create a roadmap

Documenting an actionable roadmap with achievable steps will enable decision-making towards useful climate risk insights. Implementation of the strategy, governance, risk management framework, targets and metrics is thus supported.
How can Deloitte help?
We can support organisations in their climate risk journey, from climate risk assessment and integration, towards disclosure. Moreover, Deloitte can support internal audit or assurance readiness assessments on climate risk and can advise on integrating climate risk in renumeration policies.

Climate risk Quick Scan

What is it:
A four-week interactive programme with workshops to provide you with a basic understanding of climate risks and opportunities affecting your organisation, relevant regulations and a high-level plan on how to integrate climate risks in your organisation including reporting.

Results:
- Training and awareness within the organisation on climate risk and relevant regulation.
- Insights in climate risk and opportunities.
- High-level roadmap for the integration of climate risks.
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11. NBA Handleiding duurzaamheid Klimaat, Handvatten voor accountants
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