Climate risks should be reported under existing rules: A long-term shareholder position paper

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The disconnect between existing company reporting rules and the lack of disclosure of climate risks needs to be urgently addressed. The undersigned investors call on all companies to assess and report any material climate-related risks within their annual report to shareholders. This is a prerequisite for prudent and long-term capital stewardship. It is also a requirement for listed companies in most jurisdictions. It is time companies and their regulators ensured these rules were being properly implemented.

Existing laws require disclosures of foreseeable risks and losses

Reporting rules for publicly-listed entities around the world require company directors to present fully and fairly their assessment of future risks and uncertainties in their narrative disclosures to shareholders[1]. Similarly, the financial accounts that management present to shareholders are expected to provide a reliable and prudent – i.e. not over-stated – view of current performance and capital. Prudence demands that foreseeable losses and liabilities are accounted for as long as they can be measured[2].

These two company reporting requirements - disclosures of future risks and uncertainties and financial accounts - underpin responsible capital stewardship and confidence in markets. They provide the information investors, creditors and other stakeholders need to determine the current capital strength of a business; to evaluate the performance of the executive team in delivering value over time; and to offer a basis for making an informed judgment about future prospects.

Climate change is a foreseeable and material risk

Climate change threatens to destabilise economies around the world. Equally, promised action to counter climate change through rapid decarbonisation of our economies will inevitably lead to significant transitional costs and disruption[3]. Individual companies are, to varying degrees, exposed to these climate-related changes. Yet few companies adequately communicate the climate-related risks they face. In our view, these risks are foreseeable and fall into one or more of the following groups:

- **A volatile climate**: Scientists believe that climate change is accelerating. Amongst a range of consequences, extreme weather events are likely to become more frequent. Companies with supply chains in regions exposed to exceptional weather events and / or sea level rise could face major losses, write-downs, falling productivity and / or changes to sales patterns.

[1] In the EU, the Transparency Directive (2004/109/EC) and Accounting Directive (2013/34/EU) set out requirements for public entities to publish a management report each year. This report should include a "description of principal risks and uncertainties" and financial and non-financial information necessary to provide a "fair review of the development and performance" of the company. The UK further required from October 2015 that companies provide long-term viability statements that address long-term risks to solvency. In the US, listed corporations must disclose "known trends, events, demands, commitments, and uncertainties that are reasonably likely to have a material effect on financial condition or operating performance" (Item 303 of Regulation S-K) and the SEC has issued interpretive guidance as to how this relates to climate change disclosures.

[2] See, for instance, rules that underpin capital maintenance in the EU as set out in Directive 2012/30/EU (particularly Article 17). The International Accounting Standards Board is expected to reinforce prudence and stewardship as core accounting principles in revisions to its Conceptual Framework in 2016.

[3] Of course, the transition also offers enormous opportunities for those providing solutions to climate change – but this position paper focuses on risk disclosures.

- **Regulatory action**: At the international meeting on climate change in December 2015 (COP21), almost 200 countries reaffirmed their commitment to limit warming to "well below" 2^{o}C above pre-industrial levels[4]. To achieve this goal, greenhouse gas emissions will need to be net zero in the second half of this century[5]. Steps are already underway to wean the world's energy system off oil, gas and coal. Any company that depends on burning fossil fuels – both directly or indirectly via its supply chain – needs to navigate the transition to a cleaner energy system.
- **Technological disruption**: Falling costs and improving performance of renewable energy, energy storage and highly energy-efficient appliances and buildings mean we are close to market-driven tipping points that will - irrespective of additional government support - accelerate the move away from fossil fuels. These changes could also upend the economics of entire industries.

At the very least, for companies where the risks are potentially material, disclosures should include a discussion of future risks and uncertainties facing the business, and how the Board is managing them. For companies where impairments or losses are likely, the Board should ensure financial statements present a prudent view of capital and performance.

Disclosure of climate-related risks is needed to underpin long-term stewardship

As long-term investors, we welcome robust government action to confront the climate threat. But the impacts of climate change, regulatory action and technological disruption are likely to be far-reaching and potentially destabilising[6]. Companies need to adapt. The resilience of companies will depend on early recognition of related risks and foreseeable losses.

The disconnect between existing company reporting rules and the lack of disclosure of climate risks needs to be urgently addressed. The undersigned investors call on all companies to assess and report their climate-related risks within their annual report to shareholders. This is a prerequisite for prudent and long-term capital stewardship. It is also a requirement for listed companies in most jurisdictions. It is time companies and their regulators ensured these rules were being properly implemented.

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[4]The final text from the UN sponsored 21st Conference of the Parties in Paris during December 2015 can be found at: https://unfccc.int/resource/docs/2015/cop21/eng/l09r01.pdf

[5] Article 4 of the final text from the UN sponsored 21st Conference of the Parties in Paris during December 2015. Found at: https://unfccc.int/resource/docs/2015/cop21/eng/l09r01.pdf

[6] See, for instance, Mark Carney, Governor of the Bank of England's recent speech on the financial stability risks posed by climate change: http://www.bankofengland.co.uk/publications/Pages/speeches/2015/844.aspx . Bloomberg, M., Paulson Jr, H., Steyer, T., 2014. Risky Business: The Economic Risks of Climate Change in the United States [Online] Available at: http://riskybusiness.org/site/assets/uploads/2015/09/RiskyBusiness_Report_WEB_09_08_14.pdf.

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