

# FOUNDATIONS OF THE TCFD FRAMEWORK

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TESTING THE MARKET

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# APPRECIATING THE LIMITATIONS OF THE MARKET

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- TCFD recommendations and framework represents significant potential
- TCFD premise founded on a strong market focus
- An appreciation of potential pitfalls ensures expectations are realistic and that implementation can be managed for biggest bang for buck.

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# CONSIDERATIONS RAISED IN THE ACADEMIC LITERATURE

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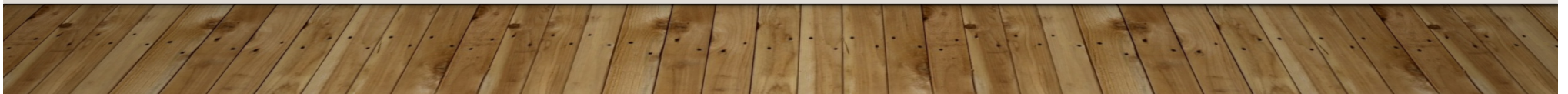
- Four predominant considerations concerning the strong reliance on markets of the TCFD framework are apparent in the academic literature:
  1. It's unlikely that the TCFD framework as it stands will drive transition fast enough.
  2. Financial sector motives may not be consistent with a stable climate
  3. Financial systems have very little regard for social inequities
  4. The nature of climate change significantly hinders accurate allocation of capital.

# I. IT'S UNLIKELY THAT THE TCFD FRAMEWORK AS IT STANDS WILL DRIVE TRANSITION FAST ENOUGH

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- “... *disclosure of climate-related information and enhanced market discipline cannot emerge rapidly enough without action by policymakers or supervisory authorities*” (Network for Greening the Financial System, 2019, p.33)
- Disclosure frameworks involve many years of iterations of trial and error before a robust reporting framework is developed. (McGuinness Institute, 2019)
- Challenges specific to climate risk such as data availability, the scope of reporting, and an absence of agreed and accepted methodologies will likely slow development even more.

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## 2. FINANCIAL SECTOR MOTIVES MAY NOT BE CONSISTENT WITH A STABLE CLIMATE

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- There is a potential tension between managing financial stability and reducing emissions and practice rapidly enough to mitigate the drivers of extreme weather
- Concerns amongst financial regulators to safeguard global financial stability from sudden price shocks and devaluation of fossil fuel assets could motivate a slower transition to a net zero economy to the detriment of global climate stability (Schellhorn, 2016)

### 3. FINANCIAL SYSTEMS HAVE VERY LITTLE REGARD FOR SOCIAL INEQUITIES

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- Financial markets discriminate purely on financial terms
- Financial information asymmetries are opaque at best and invariably stacked against those on the periphery or excluded from the financial markets
- *“if the global climate–finance system “manages what gets measured,” the most extreme dangers are likely to manifest among those whose interests are neither measured nor managed. This is the global poor” (Farbotko, in press).*

## 4. THE NATURE OF CLIMATE CHANGE HINDERS ACCURATE ALLOCATION OF CAPITAL

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- A. Accurate Assessment of Climate Risk
- B. Maturity and application of risk assessment tools
- C. Meeting the challenge of the Tragedy of the Horizons

## 4.A. ACCURATE ASSESSMENT OF CLIMATE RISK

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- Potential impact of climate change closer to “uncertainty” than “risk”
  - Risk represents outcome with knowable probabilities
  - Uncertainty represents outcome with unknowable probabilities
  - Risk is calculable but “*it is easier to bottle the wind*” than accurately project and calculate the uncertainty of a climate changed future (Christophers, 2017, p.1129).
- Uncertainties in physical risk amplified further by myriad of paths to (or not to) net zero carbon economy, i.e. transition risk
- Herd Mentality
  - participants blindly follow as opposed to undertaking their own independent analysis, represents a significant barrier to the realisation of methodological improvements and rational risk assessment



## 4. B. MATURITY AND APPLICATION OF RISK ASSESSMENT TOOLS

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- Recent article in Science (Keenan, 2019) raises concerns about the quality of tools emerging in a rapidly expanding climate services industry:
  - Opacity of models applied to quantify climate risk prevents any form of quality control and confidence that the premises and information on which they are applied are valid.
  - Opacity could also contribute to misapplication of model results where taken out of context.

## 4. C. MEETING THE CHALLENGE OF THE TRAGEDY OF THE HORIZONS

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- Capacity in the market place and the nature of the investment potentially challenges forward-looking disclosure.
- Nature of market place motivates short over long term view and behaviour:
  - annual compensation cycle
  - Investor expectations
- Capacity:
  - As noted earlier: maturity of tools and methodologies

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