KPMG

Are you ready for climate related risk management?

How the TFCD final recommendations affects oil and gas companies

Introduction

The impact of climate related risks on a company are becoming a prominent feature of public discourse. Importantly for CEOs, investors are regularly embedding environmental, social and governance risk into their screening criteria.

Several companies, including ExxonMobil[a], have been challenged on their response to climate-related risks by prominent shareholders in recent months. Building on this, it was revealed that shareholders are suing Commonwealth Bank of Australia[b] for what they say is a failure to properly disclose the risks to the business posed by climate change; the first case anywhere in the world to test how companies are required to disclose climate-related risks in court.

Task Force on Climate-related Disclosures (TCFD) recommendations

With this in mind, the Financial Stability Board's (FSB) Task Force on Climate-related disclosures (TCFD)[c] presented its final report in June 2017, setting out recommendations for helping businesses disclose climate-related information. Whilst the recommendations are voluntary, it could be considered as a basis on which future legislation could be built. Additionally, some large institutional investors have already begun requesting such information. Therefore it would be prudent for oil and gas companies to be pro-active and plan for the future today.

Note: (a) https://www.bloomberg.com/news/articles/2017-08-04/the-church-of-england-takes-on-climate-change-and-generates-a-17-percent-return
https://www.blackrock.com/corporate/en-gb/literature/publication/blk-vote-bulletin-shell-may-2017.pdf
(b) https://www.theguardian.com/australia-news/2017/aug/08/commonwealth-bank-shareholders-sue-over-inadequate-disclosure-of-climate-change-risks
(c) https://www.fsb-tcfd.org/publications/public-consultation/

The aim of the Task Force is to 'establish recommendations for disclosing clear, comparable and consistent information about the risks and opportunities presented by climate change'. With the ratification of the Paris Agreement early in 2016, over 200 countries agreed to reduce greenhouse gas emissions, the implication of which is a move away from fossil fuel energy generation.

The binding agreement aims to keep global warming below 2˚C, which is considered the threshold for safety, with the aspiration to pursue a tougher target of not exceeding 1.5˚C. The United Nations Environment Programme (UNEP) estimates that we are on track for global warming of up to 3.4˚C, and that current commitments made will not be enough to limit temperature increases to below 2˚C (d), highlighting the mounting challenge ahead.

Recommendations of the TFCD

The Task Force developed four widely-adoptable recommendations on climate-related financial disclosures, structured around four thematic areas: governance, strategy, risk management and metrics and targets (see the table below).

The report suggests that organisations which are less resilient to the transition to a lower-carbon economy may experience lower returns. Given the long term and uncertain nature of climate-related risks, this is open to debate and was challenged post publication of the draft report.

In response to the draft report, IHS Markit highlighted its concern that TCFD recommendations would undermine market functioning and potentially undermine the FSB's goal of improving capital allocation decisions. It also outlined that requirements for inappropriate disclosures could cause the mispricing of risk and distort markets[e].

In a similar vein, the Financial Reporting Council responded[f] to the phase II consultation by questioning whether applying a boilerplate approach may result in immaterial disclosures, and instead proposed a principle-based approach with less emphasis on lists of suggested disclosures; these concerns (and those of the other respondents) were taken on board by the Task Force and addressed in the final report.

Governance	**Strategy**	**Risk management**	**Metrics and targets**
Disclose the organisation's governance around climate-related risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning where such information is material.	Disclose how the organisation identifies, assesses, and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.
Recommended disclosures	**Recommended disclosures**	**Recommended disclosures**	**Recommended disclosures**
Describe the board's oversight of climate-related risks and opportunities. Describe management's role in assessing and managing climate-related risks and opportunities.	Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long term. Describe the impact of climate-related risks on the organisations businesses, strategy, and financial planning. Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2˚C or lower scenario	Describe the organisation's processes for identifying and assessing climate-related risks. Describe the organisation's process for managing climate-related risks. Describe how processes for identifying, assessing, and managing climate- related risks are integrated into an organisation's overall risk management.	Disclose the metrics used by the organisation to assess climate-related strategy and risk management process. Disclose Scope 1, Scope 2 and if appropriate Scope 3 greenhouse gas (GHG) emissions, and the related risks. Describe the targets used by the organisation to manage climate-related risks and opportunities, and performance against targets.

Source: TCFD: Task Force on Climate-Related Financial Disclosures

Note: (d) https://europa.eu/capacity4dev unep/document/emissions-gap-report-2016-unep-synthesis-report
(e) https://www.ihs.com/Info/0417/climate-financial-risk.html
(f) https://www.frc.org.uk/news/february-2017/frc-responds-to-climate-related-financial-disclosu

The KPMG view

Addressing climate change risks is likely to become of increasing importance to regulators, lenders and insurance underwriters alike in the months and years ahead. Major oil and gas producers have already begun to take this on board; for example both Royal Dutch Shell and Total S.A. have established 'New Energy' divisions. Shell is planning to spend $1 billion per year on new energies by 2020[g] and Total stating their goal of achieving a low-carbon business portfolio weighting of 20% by 2035[h].

In the UK, revisions to corporate governance disclosures resulted in the Financial Reporting Council introducing new reporting requirements, like the 'viability statement' for listed companies from 2014. This requires a broader statement over the viability of the business over a longer term than the 12-month period currently assumed. Given the long-term nature of climate-related impacts on a business, we can envisage climate-related disclosures becoming an integral part of viability statements for oil and gas related organisations in the future. We expect that implementation of TCFD recommendations to evolve over time and suggest companies stay abreast of latest developments on climate-related financial disclosures.

Update to the Final Report (post December 2016)

Post publication of the draft report in December 2016, the Task Force engaged with the public and industry to gain an understanding of the challenges faced in preparing disclosures consistent with the Task Forces' recommendations. This was with the aim to 'balance the burden of disclosure on preparers with the need for consistent and decision-useful information for users'.

The table below summarises the areas which the Task Force identifies as warranting further research:

Key areas for further work	
Relationship to other reporting initiatives	— Encourage standard setting organisations and others to actively work toward greater alignment of frameworks
Scenario analysis	— Further develop applicable 2°C or lower transition scenarios and supporting outputs, tools and user interfaces — Develop broadly accepted methodologies, datasets, and tools for scenario-based evaluation of physical risk by organisations — Make datasets and tools publicly available and provide commonly available platforms for scenario analysis
Data availability and quality and financial impact	— Undertake further research and analysis to better understand and measure how climate-related issues translate into potential financial impacts for organisations in financial and non-financial sectors — Improve data quality and further develop standardised metrics for the financial sector, including better definition of carbon-related assets and developing metrics that address a broader range of climate-related risks and opportunities — Increase organisations understanding of climate-related risks and opportunities
Example disclosures	— Provide example disclosures to assist preparers in developing consistent disclosures with the Task Force's recommendations

Source: Financial Stability Board's (FSB) Task Force on Climate-related disclosures (TCFD)

Whilst the final report indicates a move towards standardising climate-related reporting requirements, it is possible that future regulation could be embedded into existing financial frameworks. As we highlighted in our previous recommendations for oil and gas companies[i]; for the SPE-PRMS, and SEC proved reserve reporting guidelines to include a climate-related component, as well as technical and financial considerations, is a distinct possibility.

Note:
(g) https://www.bloomberg.com/news/articles/2017-07-10/shell-plans-to-spend-1-billion-a-year-on-clean-energy-by-2020
(h) http://www.total.com/sites/default/files/atoms/files/integrating_climate_into_our_strategy_eng.pdf
(i) https://home.kpmg.com/uk/en/home/insights/2017/02/task-force-on-climate-related-financial-disclosures.html

What action can oil and gas companies take?

Following on from the Task Force's second public consultation, companies said scenario analysis is a useful tool to understand the potential impact of climate change, but asked for standardised scenarios and clarity around what type of information should be disclosed (see table on page 3).

Scenario analysis applicable to a 2°C or lower transition scenario can be problematic at the individual company level as there is no definitive framework detailing how reductions in emissions will be managed at a global level, or even within industries. Nonetheless, oil and gas companies routinely use scenario analysis when developing resources and can already (potentially) include a climate-related component in their analysis.

As an example, oil and gas companies can stress test their own pre-development portfolios today by applying a theoretical climate-related tariff on all future development projects. This may subsequently play a role in differentiating projects by carbon emission impact at final investment decision (FID), and so can be assessed alongside other technical and financial metrics. This also has the advantage of benchmarking project specific climate-related risks against more traditional sources of uncertainty affecting upstream oil and gas projects such as commodity price and production profile variations. This allows management teams to assess the materiality of climate-related risks against other factors.

Whilst climate related risks for oil and gas companies go beyond a carbon price, this type of pro-active, industry leading approach would take on board the spirit and recommendations of the Task Force, by demonstrating a strong commitment to tackle climate change to investors and regulators alike, and making visible how the organisation is becoming fit for the future.

There is significant momentum behind this issue and that is likely to continue. To be prepared for the changes coming, companies should proactively consider the following considerations, and begin to embed any necessary changes into business models and processes.

Key considerations for oil and gas companies

1

How robust is our business under differing climate-related scenarios?

Are climate-related issues considered in our strategy discussions?

Do our risk management and governance processes consider climate change?

2

Are our non-financial KPIs sufficiently informing climate-related financial risks and do we properly use them to manage risks?

How flexible are our investment commitments to adapt in a timely manner to the energy transition?

3

How are we quantifying climate-related risks?

How can we assess the potential materiality of climate-related risks against other more traditional considerations?

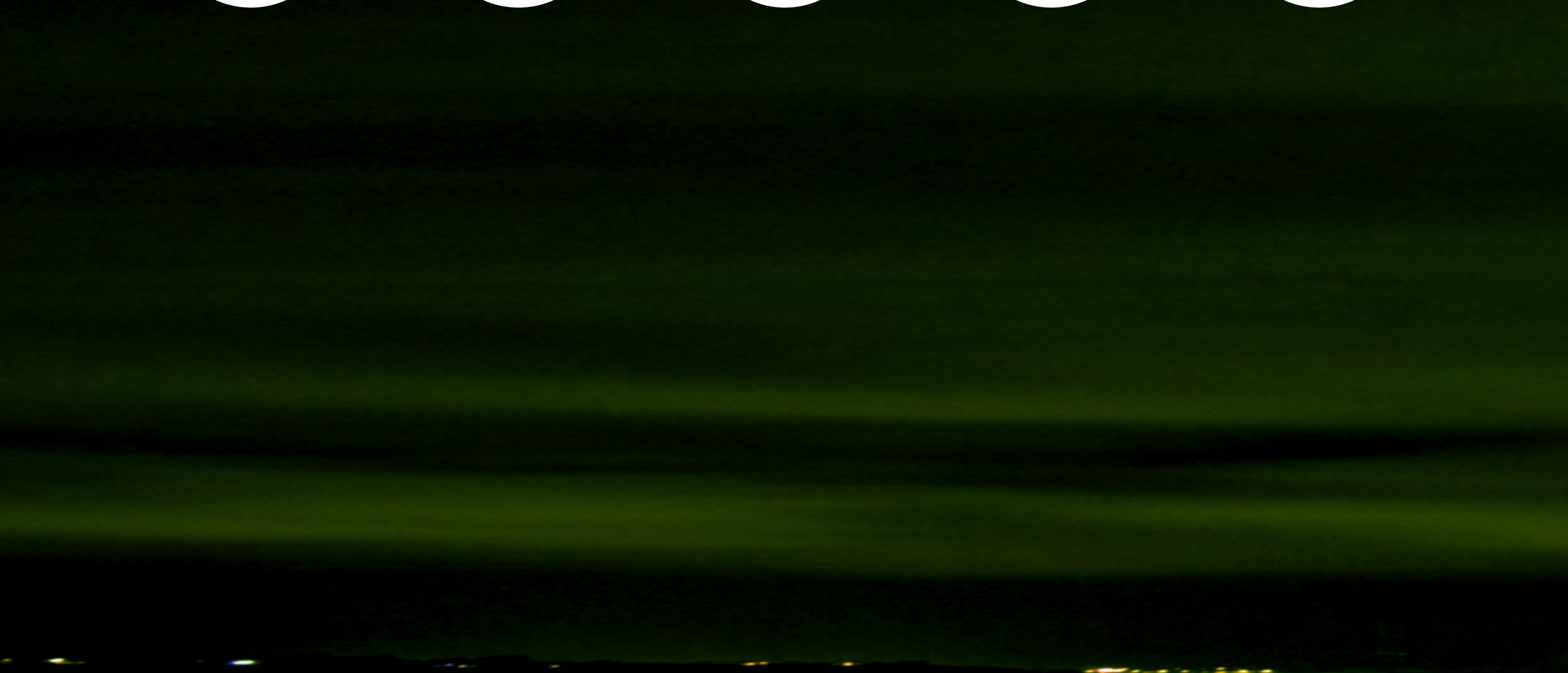
4

Are there climate-related opportunities for us to exploit?

Can we differentiate our offering to investors by taking industry-leading positions in our response to climate change?

5

Can we use existing joint venture frameworks at both a national and international level to demonstrate our commitment to, and expand our understanding of climate-related risks and opportunities?



Our advice is to start now with a full assessment of where climate-related risk lies within your organisation, with a focus on the transition and physical risks prioritised by the Task Force.

KPMG can help you:

— Review your existing governance for identifying climate related risks and opportunities, and provide recommendations for improvements where appropriate.

— Assess the current processes and data quality for identifying and reporting climate-related risks.

— Define appropriate scenarios and test the robustness of your portfolio under these scenarios.

— Assess your existing risk management framework and provide recommendations for improvements where appropriate.

— Determine appropriate metrics and systems for reporting carbon emissions, and design the performance management systems for reporting progress against carbon reduction targets.

— Develop the appropriate tools and procedures to assess the potential financial impact of climate risks.

— Provide advice relating to on-going regulatory developments in climate change matters by the TCFD or other organisations.

— Carry out a market assessment of the energy markets, and energy transition related opportunities.

Understanding climate-related risks and building them into financial reporting will be challenging. While there is no immediate requirement to disclose the information publicly; we would be happy to discuss this further with you now to help you get ahead.

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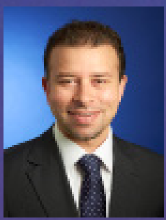

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