Breathe Easy: The Push for Climate-Related Financial Disclosure

As the impacts of climate change become more evident, regulatory and investor scrutiny on climate-related disclosures is expected to intensify. Climate-related financial disclosures—requirements that force companies to determine and disclose how climate change could affect their future profitability—are becoming the new global norm.

Investors, regulators and other stakeholders want to understand how Canadian companies are managing their climate-related risks and opportunities. To do this, they're turning to companies' public disclosures in search of clear and detailed climate-related financial information.

Investors in Canada are increasingly looking for companies that are transparent about their climate risks and are taking proactive steps to manage them. This trend is driving the demand for more detailed and reliable climate-related financial disclosures.

Tiff Macklem, Governor of the Bank of Canada, put it this way "Global standards are emerging for declaring sustainability and climate-related risks. At the Bank, we are exploring how we can align our climate disclosures with these emerging standards."

Why the heavy focus on this topic?

It's important to know if companies and markets are cutting emissions in line with national and global goals. Besides helping investors make better informed decisions, the aim is to help the transition to a low carbon economy. Companies that fail to adequately disclose climate-related risks may face a negative impact on their valuation, as investors seek to avoid potential financial risks associated with climate change.

What are the risks related to climate change?

Climate-related risks include both physical and transition risks. Physical risks refer to financial risks from the increasing severity and frequency of climate-related extremes and events and indirect effects of climate change such as public health implications. Transition risks refer to the financial risks related to the process of adjustment towards a low-greenhouse gas (GHG) economy. They can be the result of current or future government policies, regulations as well as technological advancements.

Where are we at in Canada with respect to reporting requirements?

In April 2022, the Canadian government released its federal budget announcing mandatory reporting of climate-related financial risks for all federally regulated financial institutions starting in the fiscal year of 2024. This includes all major Canadian banks and all federally incorporated or registered insurance companies. Although mandatory reporting requirements will initially only apply to federally regulated financial institutions, other organizations will be affected in the future as well.

Starting from 2024, businesses and organizations that fail to meet the compulsory disclosure requirements or are misleading risks can be faced with lawsuits, injunctions, and severe fines – as we have witnessed with other mandatory ESG legislations around the world.

To comply with rising expectations in terms of climate financial disclosure, many Canadian companies are adopting the framework developed by the Task Force on Climate-Related Financial Disclosures (TCFD) in their climate reporting. By seeking to make firms' climate-related disclosures more consistent and comparable, the quality of reporting will improve as companies work to incorporate data into their risk management, strategic planning and decision-making processes.

The TCFD's recommendations for climate-related financial disclosures are structured around four pillars: Governance, Strategy, Risk Management and Metrics and Targets. Leading organizations are able to clearly define their sustainability strategy, use science based targets related to climate risks and opportunities and analyze climate scenarios based on the unique characteristics of their industry.

While the TCFD was disbanded in October 2023, this does not affect mandatory requirements in terms of TCFD disclosures. The FSB has asked the IFRS Foundation to take over the monitoring of the progress of companies' climate-related disclosures.

Despite increasing regulatory pressure, many Canadian companies are slow to be on board. PwC Canada studied the ESG reporting of Canada's top 250 public companies and found that 59% don't mention TCFD or its principles in their disclosures despite increasing interest from investors and stakeholders.

Compliance can have a significant effect on the bottom line. In a Global Investor Survey, PwC Canada found that nearly three-quarters (73%) of investors in Canadian companies say managing regulatory risks is an important factor in including sustainability in their investing decision.

Despite increasing pressure to disclose climate-related information, there are still significant challenges for Canadian companies:

Sector-Specific Challenges: Different industries face unique challenges when it comes to climate-related disclosures. For example, the energy and mining sectors, which are significant in Canada, must provide detailed information on their carbon emissions and transition plans.

Data Availability and Quality: One of the biggest challenges for Canadian companies is the availability and quality of data needed for climate-related disclosures. Many organizations struggle with collecting accurate and consistent data on emissions and climate impacts.

Standardization Issues: While global frameworks like the TCFD provide guidelines, there is still a lack of standardization across industries, making it difficult for investors to compare disclosures across companies.

Litigation Risk: Companies that fail to disclose climate-related risks adequately may face legal challenges, particularly if stakeholders believe they have been misled about the company's exposure to climate risks.

Reputation Management: Transparent climate-related disclosures can enhance a company's reputation, while poor or inconsistent disclosures can damage it, particularly as consumers and investors become more climate-conscious.

With the increasing impact of climate change on global markets, it seems that climate-related financial disclosure is here to stay. Companies who embrace change and adapt will lead the pack as investors and other stakeholders will reward them for their responsible decision making.