This section gives an overview of the background and purpose of TCFD. The relevance to, and role of, fund managers in addressing climate change is discussed. The adoption and degree of uptake of TCFD is summarised, including an outline of some of the key regulatory developments. Finally, some of the benefits and challenges of adopting the TCFD for fund managers are outlined.

Key Messages

- Several drivers are supporting private equity (PE) action on climate change. These include pressure from Limited Partners (LPs), visible evidence of the physical impacts of climate change, increasing regulation and changing expectations from a range of stakeholders.
- Investment opportunities are another driver for action. Research suggests that to maintain a below 2˚C trajectory needs investment ranging from $2.4 trillion to $4.5 trillion [4].
- The TCFD recommendations have become the global, cross-sector, and go-to climate framework, with significant momentum around their adoption. The TCFD and climate-related disclosures are increasingly forming the basis of regulatory requirements around the world. In addition to the TCFD, in June 2023, the International Sustainability Standards Board (ISSB) also issued the IFRS S2 on Climate-related Disclosures. Although these new requirements may become more prominent than the TCFD over time, they are broadly aligned with the recommendations of the TCFD.
- What this all means is that investment companies in all regions are looking to their investment portfolios to manage climate change in a more strategic way.

1 Climate change and the role of finance and fund managers

Understanding and awareness of climate-related risks and opportunities has intensified across business in recent years. The main drivers supporting private equity action on climate include [1]:

- Growing pressure from LPs for PE firms to further integrate climate-related risk into their investment processes to align with climate goals and initiatives.
- Increased understanding of the systemic nature of climate impacts, heightening the possibility that investment performance will be significantly affected by climate-related factors.
- Political momentum leading more government entities to legislate for and promote climate-friendly activity and growth.
- Regulatory changes increasing the requirements on public and private market actors to disclose climate and wider ESG-related activity.
- Changing expectations from a wide range of stakeholders, including customers, suppliers, non-governmental organisations (NGOs), portfolio companies, media, and potential employee talent calling for climate alignment.

Climate change presents a significant opportunity for the PE sector. Increasing awareness of investment returns and opportunities related to climate change has resulted in more private investment being directed toward climate solutions [2]. Although $100 billion of climate finance has been pledged, estimates indicate far greater financing will be needed to achieve a low carbon transition. In its *Net Zero by 2050 Roadmap*, the International Energy Agency (IEA) estimates that annual investment in electricity distribution needs to grow by $560 billion, while investment in renewable energy generation must reach $4 trillion by 2030 [3]. The Intergovernmental Panel on Climate Change (IPCC) indicated that investment needs are likely to be in the $2.4 trillion to $4.5 trillion range to maintain a below 2˚C trajectory [4]. Other studies have estimated $1 trillion of investment per year needed in emerging markets [5].

Fund managers can help mitigate the effects of the climate crisis by developing finance solutions that will support a just and equitable transition of the economy into the low-carbon and climate-resilient future. For example, Canadian PE firm Brookfield Asset Management announced plans to raise at least $7.5 billion for a new climate-focused fund [6].

2 What has been the uptake of the TCFD

recommendations?

One of the essential functions of financial markets is to price risk to support informed, efficient capital-allocation decisions. To achieve this, financial markets need clear, comprehensive, and high-quality information on the risks associated with climate change. This includes the risks and opportunities presented by rising temperatures, climate-related policy, and emerging technologies.

The Financial Stability Board (FSB) established the TCFD to develop recommendations on the information companies should disclose to support investors, lenders, and insurance underwriters in appropriately assessing and pricing risks related to climate change. These recommendations are widely adoptable and applicable to organisations across sectors and jurisdictions, and have become the global, cross-sector climate framework. They are designed to solicit decision-useful, forward-looking information that can be included in mainstream financial filings.

From 2017 to 2022, the TCFD has seen significant momentum around adoption of and support for its recommendations. In particular, the number of organisations disclosing information in line with the TCFD recommendations has steadily increased each year, as has the amount of TCFD-aligned information companies disclose, as outlined in Figure 1 [7].

Figure 1: TCFD adoption and market coverage

View Figure 1

There have been significant actions by regulators and international standard setters to use the TCFD recommendations in developing climate-related reporting requirements and standards. For example, the International Financial Reporting Standards (IFRS) Foundation, a global organisation that oversees financial accounting standards in more than 140 jurisdictions, set up the International Sustainability Standards Board (ISSB) to develop globally comparable sustainability information for capital markets. In 2022, the ISSB published general sustainability-related and climate-related disclosure requirements, and in February 2023, unanimously agreed the standard would become effective from 2024 [8]. Importantly, the ISSB's climate-related disclosures are broadly consistent with the TCFD recommendations.[1]

The TCFD and climate-related disclosures are increasingly forming the basis of regulatory requirements around the world. So far, eight countries have or will be enforcing TCFD-

aligned climate disclosure in the coming years: UK (2022), Japan (2022), New Zealand (2023), Singapore (2023), China (2025), Switzerland (2024), Canada (2024), and France (2021) [9]. This mandatory disclosure requirement will include fund managers over time. For example, asset managers in the UK, including private equity, above a £5 billion asset management value threshold are required to report in line with TCFD by June 2024.

In developing economies, TCFD-aligned reporting requirements are being introduced on a voluntary basis. The Johannesburg Stock Exchange (JSE), the largest stock exchange in Africa, introduced recommendations for aligning reporting with the TCFD for listed companies in June 2022 [10]. The Central Bank of Kenya is busy implementing a roadmap for TCFD compliance for its financial institutions [11], and the Nigerian Exchange Limited, with international support, has also published recommendations for listed entities to report in alignment with TCFD [12].

In Asia, several countries have adopted the TCFD framework as a basis for ESG reporting regulations. The Hong Kong Exchanges and Clearing Limited (HKEX) published guidance in November 2021 for listed companies to report on climate disclosures following the TCFD recommendations. On the Tokyo Stock Exchange, listed companies have been required to meet TCFD requirements since April 2022 [13]. In Southeast Asia, the Indonesia Stock Exchange (IDX) became a TCFD supporter in June 2021 as part of its ambition to support sustainability in Indonesia’s capital market. In November that year, the Stock Exchange of Thailand (SET) announced its support for the TCFD [14], while the Singapore Exchange published climate disclosure rules aligned with TCFD recommendations in December 2021.

The TCFD believes this momentum has been driven by the continuing growth in investor demand for companies to report information in line with the recommendations. For example, as part of Climate Action 100+, 700 investors with over $68 trillion in assets under management are engaging the world’s largest corporate GHG emitters to strengthen their climate-related disclosures by implementing the TCFD recommendations [15]. In 2022, international not-for-profit CDP announced that over 680 financial institutions with more than $130 trillion in assets had asked 10,000-plus companies to publish their disclosures through CDP, which has aligned its climate change disclosures with the TCFD recommendations.

Further, since 2020, signatories to the United Nations Principles for Responsible Investing (PRI) have been required to report on several indicators about their management of risks and opportunities related to climate change. These indicators are modelled on the disclosure framework of the TCFD.

What this means in practice is that investment companies in these countries will be looking to their investment portfolio to consider climate change in a more strategic way and will require them to start disclosing information on how they are addressing climate change.

3 Benefits of using the TCFD recommendations

This section summarises the benefits of using the TCFD recommendations (adapted from the TCFD Guidance on Risk Management Integration and Disclosure [16]:

- Increased awareness of climate change and understanding of its associated impacts
  Greater awareness and understanding of climate-related risks and opportunities within the fund manager should result in better risk management and more informed strategic planning. Implementing TCFD can also enable fund managers and their portfolio companies to consider the opportunities that are inherent in a low-carbon transition.

- Facilitate integrated thinking
  Fully implementing the TCFD recommendations will help enable key areas of a fund manager (investment officers, chief executive officer (CEO), and ESG managers) to become skilled on climate change and its impacts. By engaging multiple business areas across the fund manager, what may have been a siloed consideration (for example by an ESG manager), can become fully integrated into the strategic decision-making of the organisation.

- Improved investor confidence to manage climate-related risk
  Easier or better access to capital for new funds can be achieved by increasing investor confidence that the fund manager's climate-related risks are being appropriately assessed and managed.

- Improved ability to meet reporting obligations
  Implementing TCFD more effectively allows fund managers to meet existing and pending disclosure requirements. As both LP and regulatory requirements increase, proactively addressing investor demand for climate-related information in a globally-established framework should ultimately reduce the number of climate-related information requests received.

4 Challenges of implementing TCFD

There are challenges for fund managers in addressing climate change and implementing the recommendations of the TCFD. These can include:

- Capacity, understanding and support
    - Perception that climate change is not relevant or material within a limited investment or holding period.
    - Limited understanding of climate issues and support for climate action among senior leadership and investment managers.
    - Limited capacity and resources to collect data and manage climate risks.
- Limited data
    - Limited access to high quality data, such as complete carbon footprints of portfolio companies, which restricts the ability to assess and manage climate risks.
- Regulatory and institutional
    - Significant changes in portfolio composition over the life of a fund.
    - Inconsistent regulatory requirements slowing climate integration in investment activity.
- Disclosure requests
    - Inconsistent and repeat requirements to disclose at various levels (at the firm, fund and portfolio company level) from different stakeholders.

[1]The key differences between the requirements in the IFRS S2 and the TCFD’s recommendations are here.