

January 27, 2021

Via electronic mail

Michael R. Bloomberg
Chair, TCFD

Ms. Mary Schapiro
Head of TCFD Secretariat

Re: Consultation on Forward-looking Financial Sector Metrics

Dear Mr. Bloomberg and Ms. Schapiro,

The Institute of International Finance (IIF) and its members, which broadly represent the global financial services industry (“industry”), appreciate the opportunity to provide high-level comments to the Taskforce on Climate-related Financial Disclosures (TCFD), and its Secretariat, on its public consultation on Forward-looking Financial Sector Metrics (“consultation”). The IIF is a global association, with close to 450 members from 70 countries, including commercial and investment banks, asset managers, and insurance companies. The comments in this letter have been informed by discussions of the IIF Sustainable Finance Working Group (SFWG), under the leadership of Chair Daniel Klier (Group Head of Strategy and Global Head of Sustainable Finance, HSBC) and Vice-Chair Judson Berkey (Managing Director and Group Head of Sustainability Regulatory Strategy, UBS).

General Perspectives on forward-looking metrics and their significance

Industry efforts to scale up sustainable finance require consistent and high-quality data on climate-related risks and opportunities in order to inform decision-making¹. The volume and quality of climate-related information disclosed by corporates and financial institutions is expanding, but is inconsistent and fragmented, and progress across sectors and geographies is uneven. These issues have been addressed in various periodic studies and assessments of TCFD implementation, including by the TCFD Secretariat,² EFRAG³, IIF/EBF⁴, and IIF/UNEPFI⁵. As is widely recognized, including by the TCFD Secretariat in its annual status reports, there are persistent challenges associated with assessing and quantifying a forward-looking view of a firms’ climate-related risks and opportunities.

Supervisory expectations and regulatory requirements on climate-related disclosures are evolving rapidly across financial markets. The TCFD has emerged as a common reference point in official sector disclosure frameworks in several jurisdictions. The IIF has recommended that where policymakers and regulators are setting disclosure expectations they should endeavor to adopt, reference, or aim for alignment with the TCFD framework in

¹ IIF 2020 “[Back to Basics: The Sustainable Finance Pyramid](#)” (February 2020)

² TCFD 2019 “[2019 Status Report](#)” (June 2019); “[2020 Status Report](#)” (October 2020)

³ EFRAG 2020, “[How to improve climate-related reporting](#),” (February 2020)

⁴ IIF-EBF 2020 “Global Climate Finance Survey: [A Look At How Financial Firms Are Approaching Climate Risk Analysis, Measurement and Disclosure](#)” (January 2020)

⁵ IIF/UNEP-FI (2020) “[TCFD Playbook](#)” (October 2020)

setting supervisory expectations and guidelines pertaining to disclosure practices as a way to reduce risk of fragmentation⁶.

Through analysis of TCFD reports and engagement with members, the IIF has concluded that building industry consensus on a core set of metrics could help bring greater consistency and comparability to disclosures⁷. On this basis, the IIF strongly supports the objectives of this consultation as they relate to better understanding the evolution of metrics used and disclosed by financial institutions, and to understand alternative forward-looking metrics that could be disclosed by financial institutions in line with the TCFD recommendations as complements to existing metrics. However, engagements with members have indicated that industry stakeholders have concerns regarding certain aspects of forward-looking metrics, which make it challenging to make robust and evidence-based judgements, or rank preferences regarding such metrics, at the current time. Further discussion of key challenges is provided in the following sections of this letter.

Considering that any TCFD-recommended forward-looking metrics may over time be reflected in official-sector frameworks and policies, it is important to ensure that steps towards standardization are appropriately phased, reflect the current state of industry practice, and the level of maturity of methodologies. Over time, agreement on a select set of recommended forward-looking metrics may be beneficial to help reduce the risk of fragmentation in disclosure requirements referencing the TCFD framework⁸. There is increasing industry interest in forward-looking metrics and their applications⁹. Efforts to leverage emerging methodologies being trialed by select financial institutions could help promote the uptake of common approaches. However, there are a range of other pressing issues with the consistency and comparability of existing TCFD disclosures that require industry consensus and eventual standardization. Considering the nascent stage of methodologies available to produce forward-looking metrics, we perceive that a period of research, development, and consensus-building is necessary to ensure that desired outcomes of standardization (e.g. greater consistency and enhanced information) are achieved, and that potential negative unintended consequences (e.g. potential selective choice of approaches and assumptions to influence quantitative outputs) are minimized.

Perspectives on usefulness of various metrics and associated challenges

Considering the nascent nature of forward-looking metrics, including Implied Temperature Rise (ITR), it may be premature to expect industry stakeholders to express formal views on the costs and benefits of different metrics, or their usefulness in the context of financial decision-making. There are many aspects of forward-looking metrics which would benefit from further work, as outlined in Question 14 of the consultation form. For certain emerging metrics, all listed ‘changes’ (e.g. more clarity and transparency in methodologies, greater comparability of approaches, standardized assumptions, and higher quality data) will be needed to improve decision-usefulness. Considering the evolving understanding of transmission channels for climate-related risks and their financial impacts, there may be challenges in reusing some existing metrics (e.g.: Value at Risk) in a forward-looking context. In particular, the use of historical time series data to calibrate metrics may be

⁶ IIF “[Prudential Pathways: Industry Perspectives on Supervisory and Regulatory Approaches to Climate-related and Environmental Risks](#)” (December 2020, Discussion Draft)

⁷ IIF/UNEP-FI (2020) “[TCFD Playbook](#)” (October 2020)

⁸ Ibid.

⁹ For instance, 130 banks have committed under the Principles for Responsible Banking to align their credit portfolio with the Sustainable Development Goals; some banks are employing forward-looking approaches based on sector specific climate scenarios to assess alignment.

questionable in the context of climate-related risks, insofar as such data may not be reflective of future climate events.

At a foundational level, transparency on methodologies – and clarity on the degree of consistency of outputs that may result from different approaches – is necessary for forward-looking disclosures to be comparable. As recent research examining risk metrics has concluded, while a degree of convergence may exist across different metrics on which firms may be least or most exposed to climate-related transition risks, different approaches may yield significantly different assessments of the risk exposure of a given firm¹⁰.

Recognizing that the TCFD’s efforts to advance towards standardization must contend with and reflect a dynamic and iterative process of innovation in approaches and methodologies, a phased approach to different types of metrics may be appropriate given varying levels of maturity. We would recommend the following set of questions to guide thinking around the choice and endorsement of alternative forward-looking metrics that could be disclosed by financial institutions as complements to existing TCFD-recommended metrics:

- What are the fundamental aspects of forward-looking metrics which are less open to interpretation or debate, how do they fit with emerging methodologies already being used, and how could they benefit from near-term standardization?
- For which metrics are there emerging best in class methodologies, or on which there is less debate, where steps towards standardization should be explored?
- In areas where approaches are less mature, where is there continuing value in diverse thinking, where the industry should not prematurely ‘pick winners’?
- Where are common approaches required to ensure that metrics are calculated in a consistent way, for instance, agreement on the granularity of risk analysis (e.g. portfolio or company level)?
- How can the principle of proportionality be considered, to ensure that forward-looking metrics are applied to relevant asset classes and holding that are significant for a given institution?

Finally, it is important to recognize that different forward-looking metrics have different use cases, and will be more or less relevant for financial institutions depending on their business models. Metrics relevant for institutional investors and asset owners, are likely to be different than those relevant for banks or insurers¹¹. Considering this, it is likely that a range of metrics may be necessary to provide a comprehensive and robust view of a firm’s climate-related risk exposures, opportunities, and targets. We would encourage the TCFD to consider formulating recommendations on groups of metrics relevant for different types of financial institutions, and guidance on how firms should disclose contextual information regarding the choice of metrics they apply. A coherent set of metrics – and detailed information on why such metrics were chosen – could help reduce the risk of inconsistency in disclosures arising from a breadth of different metrics being advanced in parallel.

It is also important for the TCFD to address potential unintended consequences that could stem from the disclosure of such metrics where methodological differences are significant. A widespread shift towards greater disclosure of forward-looking metrics in the absence of a clear understanding of the implications of differences in approaches could create a risk of disclosures not being reliable. In the absence of clear and robust verification practices to

¹⁰ CEP (2020) “[Climate Finance Risks: Assessing Convergence, Exploring Diversity](#)” (December 2020).

¹¹ Differences in life insurance and general insurance business models may also impact the capacity to develop robust forward-looking metrics.

enable market discipline, it is possible for metrics to be manipulated, potentially resulting in greenwashing or mis-selling.

Perspectives on the Implied Temperature Rise (ITR) metric

The ease of interpretation of ITR ratings make them understandably attractive for investors; however, this apparent simplicity belies the highly complex processes required to develop robust views of ITR scores at portfolio levels, and differences in financial institutions' business models. For bank business lines such as mortgages and consumer credit, methodologies to evaluate the core underlying data points on which an ITR rating would rely (e.g. financed emissions) are still at an early stage. In corporate credit and other types of financing, where banks' largest counterparties are other large financial institutions, the absence of a transparent, sophisticated and detailed view of a counterparties' balance sheet can impede efforts to develop a robust portfolio-level view. In addition, the aggregation of the ITR of different sector-based credit portfolios at the consolidated balance sheet level may be misleading, as it could implicitly 'offset' the emissions reductions of faster-transitioning and slower transitioning sectors. The progress and rate of sectoral transitions towards the goals of the Paris Agreement are important. For example, if the automotive sector were to transition fully to electric vehicles while the power sector remained significantly dependent upon fossil fuel generation, the lack of transition in electricity generation could reduce the emissions reductions impacts of the automotive sector's transition. An aggregated view could potentially indicate that the automotive sector's transition makes up for the power sector's lack of progress.

Key issues associated with the current state of play of ITR ratings include a general opacity in the methodologies available from different third-party providers, and significant variation in the results when taking different approaches. There is evidence from 2020 TCFD reporting that ITR ratings can diverge significantly on the basis of methodological approaches and subjective choices. Furthermore, as the robustness of ITR ratings is contingent on the strength of other metrics, certain firms may be at an advantage or disadvantage depending on data availability and quality, the degree of maturity of methodologies to calculate underlying variables (e.g. emissions profiles of specific sectors, transition pathways, etc.), and exogenous factors affecting scenarios relevant to the jurisdictions in which they operate (e.g. presence or absence of clear transition policies at sector level).

Perspectives on when and how forward-looking metrics could be incorporated into the TCFD Recommendations

Considering the wide variation in methodologies, data challenges, and lack of agreement on a preferred approach, we believe that it is too soon to formally incorporate a set of forward-looking metrics into the core of the TCFD Recommendations at the present time. While we believe a standardized set of forward-looking metrics could ultimately be an important component of the range of indicators that corporates and financial institutions use to quantify climate-related risks and opportunities, we would stress that the key issue at present is flexibility to allow the experimentation that will permit the convergence on appropriate metrics over time. In this context, a key consideration is the timing and phasing of any steps that the TCFD may take to formalize a set of forward-looking metrics over the course of 2021/22.

Recent publications analyzing the current levels of maturity of forward-looking metrics attest to the need for further development before standardization can be effectively pursued. For instance, the Portfolio Alignment Team (PAT) report has concluded

that the development of “*transparent, robust and decision useful metrics of portfolio alignment will be an iterative process,*” and has identified several design issues, methodological considerations, and accounting challenges that require resolution in order for such metrics to respond appropriately to changing portfolio conditions (e.g. company level growth), while minimizing risk of inaccuracy (e.g. double counting, underestimation bias)¹². The Louis Bachelier Institute ‘Alignment Cookbook’ report contains useful data on correlations between various alignment metrics and methodologies¹³. The Credit Portfolio Alignment report of the ‘Katowice Group’ of Banks, working with the 2 Degrees Investing Initiative, provides useful examples of the types of questions and challenges leading institutions have encountered in working towards application of the PACTA methodology, and proposes some guidance to overcome them.¹⁴

Looking across recent assessments, there some common views on how progress can be made. For instance, the IIF would like to call attention to the action agenda set out by the PAT for financial institutions, methodology developers, and other stakeholders to formulate best practices and set milestones for the development of refined methods¹⁵.

As progress towards best practices continues, the TCFD may wish to consider how recommended forward-looking metrics would be integrated into the existing Recommendations and Supplemental guidance. We believe that, in due course, such metrics should be integrated into Metrics and Targets (C), and that clear guidance should be provided on how financial institutions should convey information underlying the calculation of different metrics (for instance, the data inputs, assumptions, and variables used to formulate a portfolio-level ITR). As different forward-looking metrics may be relevant to existing target setting frameworks, the TCFD should aim to provide a holistic view of how different metrics interact with methodologies developed by various initiatives and coalitions, for instance, the Science-based Targets Initiative.

Priorities for action in 2021/22

We believe that the focus for 2021 should be on continued R&D and industry dialogue to consolidate around a core set of best practices and industry consensus on the design of forward-looking metrics. Despite the significant progress made in recent years on technical aspects of TCFD disclosures, including scenario analysis, it is unlikely that any financial institution – even one at the leading edge of innovation of forward-looking metrics – can claim with confidence that its TCFD disclosures are fully compliant with the original recommendations and guidance released in 2017.

We would encourage the TCFD to aim for revisions to be initiated in early 2022, as the first five-year phase of TCFD implementation activities comes to a close. Over the short term, we would encourage the TCFD to clarify the expected processes and through which revisions to the core Recommendations and Supplemental Guidance would be completed, and the milestones for industry engagement. We believe that when proposing/defining new metrics, it is important to consider the potential future work on non-financial reporting standards (at regional and global levels) in order to ensure that the recommendations of the TCFD continue to help reduce complexity, and improve comparability.

¹² Portfolio Alignment Team “[Measuring Portfolio Alignment](#)” (November 2020)

¹³ Institut Louis Bachelier “[Alignment Cookbook: A Technical Review of Methodologies](#)” (July 2020) – See pg. 81.

¹⁴ Katowice Group/2Dii “[Credit Portfolio Alignment: An application of the PACTA methodology by Katowice Banks in partnership with the 2 Degrees Investing Initiative](#)” (September 2020)

¹⁵ Portfolio Alignment Team “[Measuring Portfolio Alignment](#)” (November 2020)

Going forward in 2021, the IIF will work with member to develop a set of shared templates for TCFD Disclosures. The objective of this work will be to find ways to better align disclosures in areas where broad divergence persists, with a core aim of harmonizing delivery of quantitative data in a consistent format. By bringing greater transparency on the approaches, data inputs, and variables used to quantify and measure climate-related risks, we hope that financial institutions will be able to collaboratively raise the bar for what good disclosure looks like. We would be pleased to engage with the TCFD and its Secretariat to identify how this work can add value to shared goals of consistent and comparable disclosures.

On behalf of the IIF Sustainable Finance Working Group, we hope that these global industry perspectives will contribute to your efforts. We would be happy to discuss any of these matters further and invite you to contact Sonja Gibbs (sgibbs@iif.com) and Andrés Portilla (aportilla@iif.com) should you have questions or comments.

Sincerely,

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