Green and Sustainable
Finance Cluster
Germany

TCFD Think Tank

Legal requirements

TCFD Recommendations - Legal risk mitigation tool

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Abbreviations

German Stock Corporation Act	Companies Act
CSR	Corporate Social Responsibility
CSR-RUG	CSR Directive Implementation Act
ESG	Environmental, social and governance factors
EU Action Plan	„Action Plan: Financing sustainable growth“ of the EU Commission of 8 March 2018 (COM(2018) 97 final)
EU-Kommission	European Commission
FSB	Secretariat to the Financial Stability Board Bank for International Settlements; Financial Stability Board
HGB	German Commercial Code (Handelsgesetzbuch)
HLEG	High Level Expert Group on Sustainable Finance

HLEG-report	final HLEG report „Financing a Sustainable European Economy“
IEA	International Energy Agency
IIDMA	International Institute for Law and the Environment
IPCC	Intergovernmental Panel on Climate Change (auch “Weltklimarat”)
KPI(s)	Key Performance Indicator(s)
NFRD	EU Non-Financial Reporting Directive; CSR Directive 2014/95/EU of October 22nd, 2014
SPAs	Shared Climate Policy Assumptions
SSP	Shared Socioeconomic Pathway
TCFD	Task Force on Climate-related Financial Disclosures
TEG	Technical Expert Group on Sustainable Finance
TEG-Report	Report on Climate-related Disclosures der TEG from 10. January 2019
GHG	Greenhouse gas emissions
UNFCCC	United Nations Framework Convention on Climate Change

Foreword Green and Sustainable Finance Cluster Germany

Transparency is fundamental to evaluating risks and allocating capital efficiently. For this purpose, the consistent disclosure of financial results, the handling of opportunities and risks, the status and the making of forecasts are indispensable. This also applies to understanding the effects of the climate crisis.

The analysis of climate-related risks is challenging, as neither the exact path towards a world compatible with the Paris Agreement nor the exact timing and extent of the physical effects of the climate crisis can be predicted. Many actors are only slowly recognising the significance of the climate crisis for their future economic success. In fact, changes due to the climate crisis affect all parts of the global economic system. The associated changes not only represent a considerable risk, but also open up new business opportunities for companies that strategically consider the climate crisis.

Risk-return profiles in the lending business and in asset management will change considerably as a result of the climate crisis. They are a result of the physical effects of climate change, climate policy and regulation, changing demand structures and new emerging technologies. Avoiding climate-related risks will prove difficult in certain asset classes or sectors, which may lead to a revaluation of such activities.

The Financial Stability Board has set up an industry-led Task Force on Climate-related Financial Disclosures (TCFD) to assess information relevant to climate-related risk. The TCFD has issued recommendations for the voluntary and consistent disclosure of climate-related financial information. These are intended to help investors, lenders and insurance companies understand significant climate-related risks and opportunities. Globally, the TCFD recommendations are now understood as a guideline and numerous companies have committed themselves to their implementation.

The Green and Sustainable Finance Cluster Germany e.V. (Cluster) showed in its Baseline Report published in August 2018 that the TCFD recommendations seem too abstract for German financial institutions. There is little understanding of practical implementation approaches of the TCFD recommendations. In cooperation with experienced financial market practitioners, the Cluster has therefore established a think tank for overcoming practical implementation issues. This is supported by the in-depth knowledge of the Frankfurt School of Finance & Management, PwC Deutschland, d-fine and right. based on science.

Within the framework of the TCFD Think Tank, four workshops with selected financial market practitioners were held. In the course of this process, a deeper understanding of the TCFD recommendations was built up. The findings are now made available to the interested public, in particular financial institutions, in the form of short briefs. They are tailored to the needs of practitioners in order to independently advance the implementation of the TCFD recommendations

1 NON-FINANCIAL STATEMENT

In 2015, the G20 countries commissioned the Secretariat to the Financial Stability Board Bank for International Settlements (FSB) to establish a working group to examine the impact of climate change on financial stability. On 29 June 2017, the Task Force on Climate-related Financial Disclosures („TCFD“) commissioned by the FSB published recommendations on how climate-related risks and opportunities can be better understood through climate-related information.
The recommendations of the TCFD are not legally binding and therefore have no binding effect on financial market participants. However, a binding effect can result from EU regulations, national laws, ordinances and statutes as these refer to recommendations of the TCFD.

Against this background, climate policy should be examined more closely. International climate policy is organised under the United Nations Framework Convention on Climate Change (UNFCCC). The UNFCCC currently has 197 Parties that have signed binding treaties under international law (such as the Kyoto Protocol and the Paris Agreement). According to the Paris Agreement, all industrialised countries and, for the first time, all emerging economies and developing countries commit themselves to making a contribution to international climate protection in the form of voluntary commitments. The central goals are to limit the increase in global warming to well below two degrees Celsius compared to pre-industrial levels and to make the global economy carbon neutral between 2050 and 2100.
The EU has set itself the target of reducing its annual greenhouse gas emissions by 80 to 95% by 2050 compared to 1990 levels. Legally binding interim targets are for emission reductions of 20 % by 2020 and at least 40 % by 2030 compared to 1990 levels.

In addition, the Federal Republic of Germany has set itself the national goal of reducing greenhouse gas emissions by at least 40 % by 2020 compared with 1990 levels. To achieve this goal, cities have in turn developed plans for implementation.

The city of Frankfurt am Main, for example, has developed the so-called „100% climate protection master plan“, which provides for a reduction in CO2 emissions of around 95 % by 2050.

According to the EU, these pioneering international agreements and national implementations require an effective EU strategy for sustainable finances. The European Commission (EU Commission) has therefore committed itself to take this issue forward in the „Communication on accelerating the implementation of the Capital Market Union“ (CMU). Against this background, the EU Commission set up the High Level Expert Group on Sustainable Finance (HLEG) at the end of 2016 with 20 members and 9 observers.

Following an interim report presented in July 2017 and the gathering of input from business and civil society, the final report „Financing a Sustainable European Economy“ (HLEG Report) was presented in January 2018.

Final report „Financing a Sustainable European Economy“ https://ec. europa. eu/info/sites/info/files/180131-sustainable-finance-final-report_en. pdf

The eight central recommendations of the HLEG Report form the basis of the „Action Plan on Financing Sustainable Growth“ of the EU Commission of 8 March 2018 (so-called „EU Action Plan“; COM(2018) 97 final) strive for:

- reorienting capital flows towards sustainable investments in order to achieve sustainable and inclusive growth;
- managing financial risks arising from climate change, resource scarcity, environmental degradation and social issues;
- promoting transparency and sustainability in financial and economic activities.

Following Action 9.2 of the EU Action Plan, the EU Commission has revised the guidelines on non-financial information for the second quarter of 2019. On the basis of the parameters have been developed by the Commission‘s Expert Group on Sustainable Finance and the revised guidelines provide further guidance to companies on how to disclose climate-related information in line with the TCFD recommendations and the climate-related parameters developed under the EU sustainable taxonomy. The guidelines will then be amended to include other environmental and social factors.

In May 2018, the Commission adopted a package of measures implementing several key action points from the EU Action Plan. The package includes a proposal for a regulation on disclosures on sustainable investment and sustainability risks and amending Directive (EU) 2016/2341, which introduces disclosure requirements on how institutional investors and asset managers should integrate environmental, social and governance („ESG“) factors into their risk processes. The requirements for integrating ESG factors into investment decision-making processes as part of their obligations to investors and beneficiaries are further specified by delegated acts.

The European Parliament also emphasises that disclosure is a crucial precondition for making finance sustainable, welcomes the work of the TCFD and calls on the Commission and the Council to support its recommendations. It further notes that Article 173 of the French Energy Transition Law already provides a possible template for a mandatory disclosure of climate risks by investors (Report on Sustainable Finance (2018/2007(INI)) of 4 March 2018). In March 2019, the Council and the European Parliament agreed on the proposal by the Commission for regulation on disclosures on sustainable investment and sustainability risks. Therefore, there will soon be EU-wide uniform rules for financial market participants to publish written strategies for the inclusion of sustainability risks and to ensure transparency in the inclusion of those.

France: In August 2015, France became the first country in the world to impose ESG and climate reporting obligations on investors. The implementing regulation for Article 173-VI of the French law „Energy Turnaround for Green Growth" contains three requirements: (i) providing a general description of the investor's ESG policy, (ii) disclosing the resources allocated to the ESG analysis and (iii) explaining the methodology and results of the climate risk analysis. The German Federal Ministry for the Environment, Nature Conservation, Construction and Nuclear Safety (BMUB) has commissioned a feasibility study on the subject of climate protection law and sustainability change in the financial sector, particularly in a Franco-German comparison, with a view on Article 173. Are you prepared?

Veil/Deckert/Kämmerer/Voigt, „Nachhaltige Kapitalanlagen durch Finanzmarktregulierung - Reformkonzepte im deutsch-französischen Rechtsvergleich", 2019, available at https://www. umweltbundesamt. en/publikationen/nachhaltige-kapitalanlage

Against the background of the implementation of the efforts listed above, the following TCFD recommendations are discussed as possible options for action

1.1 LIABILITY RISKS

According to the TCFD recommendations, climate-related risks can be divided into two main categories: (1) Risks related to the transition to a low-carbon economy (transition risks) and (2) Risks related to the physical effects of climate change (physical risks).

The transition to a low-carbon economy can bring about far-reaching political, legal, technological and market changes to address the mitigation and adaptation requirements. Depending on the nature, speed and focus of these changes, transition risks may represent a different financial and/or reputational risk for companies. According to TCFD, these include political and legal risks, technology risks, market risks and reputational risks.

Physical risks due to climate change occur either as an event (acute) or over time (chronic) in climate patterns and may have financial implications for organisations, e.g. direct damage to assets or indirect effects from supply chain disruptions.

Further reading

On physical risks and their consideration possibilities for banks and assets Manager see *TCFD in a nutshell* and *Physical Risks* of this publication series.

Legal disputes or legal risks as a subcategory of transition factories have been increasing in recent years. According to the TCFD, the reasons for litigation in connection with climate change are the failure of organisations to mitigate the effects of global warming („Failure to mitigate"), to adapt to them („Failure to adapt") and the inadequate disclosure of significant financial risks. The TCFD assumes that due to the increasing value of losses and damage due to global warming, the process risk will probably also increase.

Against the background of the challenges posed by these risks, the TCFD has set itself the task of developing uniform standards for the disclosure of climate-related financial risks of companies. Liability risks in particular are therefore considered below

1.1.1 PROCESS- UND REPUTATION RISIKS

Climate law is a new area of law that deals with the legal application of existing legal instruments to climate change and its consequences. A distinction is made between the responsibility of companies (in particular the energy sector; private law), which contribute significantly to climate change through greenhouse gas emissions („GHG"), and the responsibility of states (in particular protection obligations; international law). The most prominent example of the global „litigation" movement is the case of Saúl v. RWE (OLG Hamm I-5 U 15/17), which recently achieved a stage victory in history with the decision to take evidence. The court ruling will clarify whether a company can be held liable for its contribution to damage caused by climate change.

In November 2015, the Peruvian farmer Saúl Luciano Lliuya sued RWE, Germany's largest energy producer, for damages in Germany. Lliuya argues that RWE is deliberately contributing „substantially" to emissions - namely 0.47% of the world's historic GHG emissions from 1751 to 2010: The taking of evidence before the Higher Regional Court of Hamm was opened. The case shows that there might be a need to assign concrete emission-related temperature increases to a company. The more precise climate parameters become, the easier it is to associate specific contributions with specific consequences.

Eric Schneiderman, New York's public prosecutor, for example, with the support of former vice-president Al Gore and 17 other public prosecutors, initiated investigations into Exxon for „covering up climate change". The company, which is committed to transparency, is accused of violating consumer protection regulations and deceiving its shareholders. Process and reputation risks are closely linked

1.1.2 REPORTING

The transition to a < 2°C world is also accompanied by an increasingly tight legal corset for reporting by companies in the real economy and the financial sector. The aim of current European efforts is to increase transparency regarding the ecological and social aspects of business activities of large companies.

The fourth and seventh EU Accounting Directives for annual and management reports had already provided for mandatory reporting on sustainability indicators in 2003, this was extended in particular by the Corporate Social Responsibility (CSR) Directive 2014/95/EU of 22 October 2014 (also EU Non-Financial Reporting Directive („NFRD")).

According to the German CSR Directive Implementation Act („CSR-RUG"), certain large, capital market-oriented companies as well as certain insurance companies and credit institutions must now also report on non-financial aspects of CSR as part of their financial reporting for financial years beginning on or after 1 January 2017. The non-financial aspects, including other environmental concerns, are the central point of reference for all data, which may relate, e.g. to GHG, water consumption, air pollution, the use of renewable and non-renewable energies or the protection of biodiversity. For example, precise data on climate risks, measured on the basis of GHG (clustered into categories Scope 1, 2 and 3), will have to be recorded and reported.

On a national level, the CSR-RUG amended in particular §§ 289a - f of the German Commercial Code („Handelsgesetzbuch, HGB") in April 2017. § Section 289c HGB governs the minimum disclosures required by non-financial statements. This establishes minimum reporting requirements in order to ensure a sufficient degree of comparability of non-financial reporting between companies (Begründung RegE CSR-RUG, BT-Drs. 18/9982, 46 f.). A minimum quality standard for non-financial reporting in the EU Member States is to be set across borders (cf. CSR Directive, recitals 1, 4 - 6).

§ Section 289c HGB

> (1) The non-financial statement within the meaning of section 289b, the business model of the corporation shall be described briefly.
> (2) The non-financial declaration shall also relate at least to the following aspects:
> 1. Environmental concerns, [...]
> (3) In respect of the matters referred to in paragraph 2, the non-financial statement shall always contain such information as is necessary for an understanding of the development and performance of the business, the position of the capital company and

> the impact of its activities on the matters referred to in paragraph 2, including any information which may be necessary for the purpose of that understanding:
> 1. a description of the concepts pursued by the corporation, including the due diligence processes applied by the corporation,
> 2. the results of the concepts referred to in paragraph 1,
> 3. the material risks associated with the corporation's own business activities, which are very likely to have or will have serious adverse effects on the aspects referred to in paragraph 2, and the management of those risks by the corporation,
> 4. the material risks associated with the business relationships of the corporation, its products and services, which are very likely to have or will have serious adverse effects on the aspects referred to in paragraph 2, to the extent that the information is relevant and the reporting of such risks is proportionate, and the management of such risks by the corporation,
> 5. of the most significant non-financial KPIs used for the business of capital markets of importance to society, [...]

The CSR-RUG standardizes the legal obligation for CSR reporting. This obligation can be waived by means of the so-called „comply or explain" mechanism: If the capital company does not pursue a concept with regard to aspects mentioned in § 289c HGB (e.g. environmental concerns), it must explain this clearly and justifiably in the non-financial statement. CSR reporting leads to CSR supervisory board duties: Pursuant to Section 171 (1) of the German Stock Corporation Act („Aktiengesetz, AktG"), the Supervisory Board is explicitly obliged to extend its audit of the financial statements to the non-financial statement. Long before the audit, the Supervisory Board should be involved in the assessment of the CSR issues relevant to the company in an advisory capacity (so-called „obligation to be consulted", §§ 111 AktG ff.). The Board of Management could also be informed in accordance with its programme of duties in Sections 90 et seq. of the German Stock Corporation Act (AktG). CSR obligations.

> Hommelhoff, *CSR Management Board and Supervisory Board Duty*, NZG 2017, p. 1361.

Furthermore, § 331 HGB (misrepresentation) and § 334 HBG (provisions on fines) are directly related to the non-financial declaration regulated in § 289c HGB. According to these sections, anyone who, as a member of an authorized representative body or the supervisory board of a corporation, misrepresents or conceals the circumstances of the corporation in the management report, including the non-financial statement or in the separate non-financial report, may be punished with imprisonment for up to three years or with a fine (§ 331 HGB).

> At Banco Santander's Annual General Meeting on 12 April 2019, the International Institute of Law and Environment („IIDMA") challenged Banco Santander with regard to its climate policy. In addition to the demand to stop financing projects and companies

in the coal sector, the TCFD recommendations were also discussed. In response to the question of how the climate risks of coal projects are measured, IIDMA was not satisfied with the recording of the „carbon footprint“. The Bank‘s non-financial statement must contain additional data in order to comply with the Spanish implementation of the CSR Directive and the requirements of the TCFD

1.2 TCFD RECOMMENDATIONS AS AN OPTION FOR ACTION

Art. 2 NFRD provides that the EU Commission shall draw up non-binding guidelines on the method of reporting on non-financial information, including the main general and sector-specific non-financial performance indicators, in order to facilitate relevant, expedient and comparable reporting of non-financial information by enterprises. In July 2017, it published the guidelines for reporting non-financial information (Method for reporting non-financial information; 2017/C 215/01).

The EU Commission established a Technical Expert Group on Sustainable Finance (TEG) to revise this guidance for reporting to assist it in providing guidance on how to improve disclosure of climate-related information by companies.

With regard to climate-related reporting, the TEG is developing how companies should report on climate risks in line with the TCFD in accordance with point 9.2 of the EU Action Plan, which requires the EU Commission to revise the non-binding guidelines on the CSR Directive and explicitly recommend guidelines. In January 2019, the TEG published a report (Report on Climate-related Disclosures; „TEG-Report“) which should enable the EU Commission to adapt its non-binding guidelines for non-financial reporting. The TEG Report also contains sector-specific reporting indicators for banks and insurance companies which are in line with the recommendations of the TCFD (page 33 et seq.). The EU Commission had submitted for consultation the draft of an annex to its non-binding guidelines for reporting non-financial information based on the TEG Report and published an updated version in June 2019.

TEG-Report: https://ec.europa.eu/info/publications/sustainable-finance-technical-expert-group_en

Guidelines for reporting non-financial information: https://eurlex. europa. eu/legal-content/DE/TXT/PDF/? uri=CELEX:52017XC0705(01)& from=EN

Draft Annex to its non-binding guidelines for reporting on non-financial information: https://ec. europa. eu/info/sites/info/files/ business_economy_euro/banking_and_finance/documents/2019-non-financial-reporting-guidelines-consultation-document_en. pdf

1.2.1 TEG SYSTEMATICS

The TEG Report combines the national implementation of the CSR Directive (including in particular § 289c HGB) and the TCFD recommendations and provides a very granular presentation of how the legal requirements of the non-financial declaration (§ 289c HGB) can be implemented in compliance with the TCFD recommendations.

	289c HGB				
TCFD recommendations	Business model	Concepts & Due diligence	Results of concepts	Significant risks & their management	Meaningful, not financial KPIs
Governance		X			
Strategy			X	X	
Risk Management		X		X	
Metrics & Targets					X

Only the description of the business model is not taken up by the TCFD. Although § 289c (1) HGB requires that the „[...] business model of the corporation be briefly described [...]“. However, the TCFD does not explicitly address the disclosure of information relating to the general business model and strategy of the organisation, as it assumed that this information would be included in the financial records anyway. According to the TEG, the description of the business model should include financial institutions:

- Breakdown of the various business activities
- The breakdown of the geographical zones in which they operate
- Relevant information on climate-related risks and opportunities

According to this model, i.e. (1) the definition of the legal requirement of § 289c HGB, namely

- Description of the concepts pursued, including the due diligence processes applied,
- Results of the concepts
- Significant risks and their management
- Most important non-financial Key Performance Indicators (KPIs)

and (2) reporting along these requirements by means of the TCFD recommendations on the basis of the results of the TEG should allow reporting in compliance with the law.

1.2.2 REVISION OF THE EU NON-BINDING GUIDELINES

The national § 289c (1) HGB, which implements the CSR directive, requires a short description of the „[...] business model of the corporation [...]“.

The TCFD recommendations do not explicitly address the disclosure of information relating to the organisation‘s general business model and strategy, as it assumed that this information would be included in the financial records anyway.

According to the TEG report, the description of the financial institutions‘ business model should include the following:

- Breakdown of the various business activities
- The breakdown of the geographical zones in which they operate
- Relevant information on climate-related risks and opportunities

The draft Annex to the non-binding guidelines for reporting on non-financial information of the EU is intended to describe:

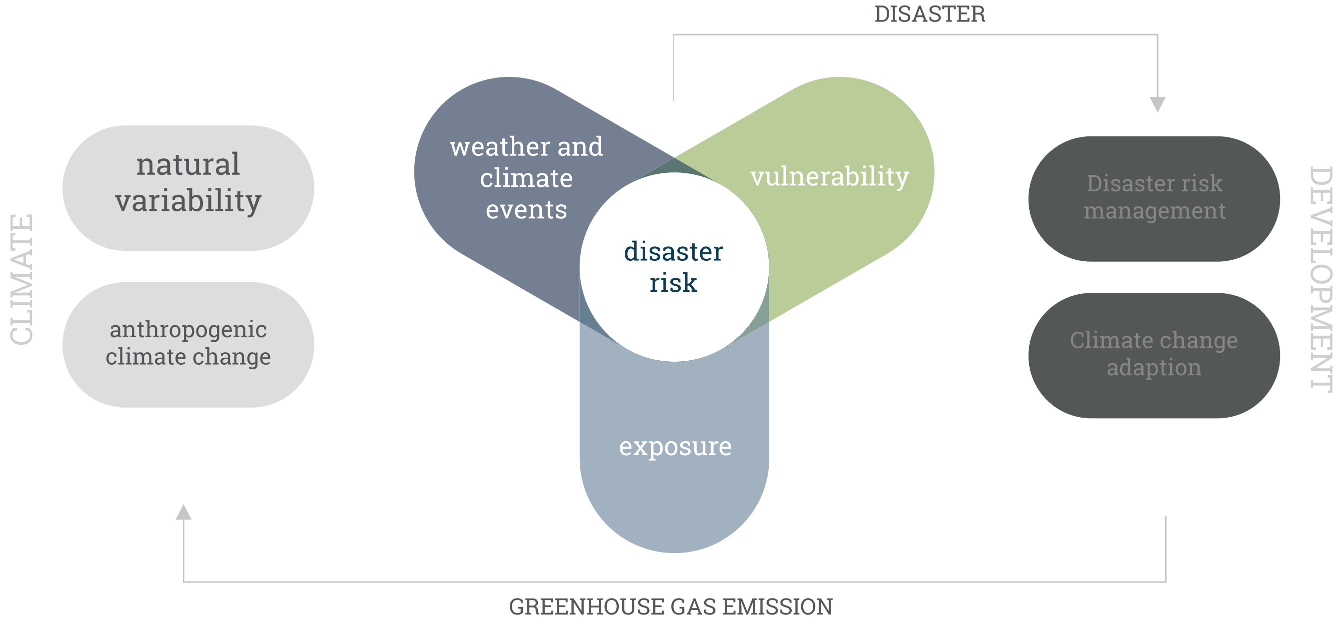
- the effects of climate-relevant risks and opportunities on the business model,
- the company‘s strategy and financial planning and how strategies can change to address potential transition and physical risks and opportunities.
- the extent to which the business model and strategy of the company adversely affects the climate and how it can contribute to mitigating and/or adapting to climate change.
- The resilience of the company‘s business model and strategy to different climate-related scenarios over different time horizons, including a scenario of at least 2°C or less and a scenario of more than 2°C.

Regarding the conduct of the scenario analysis to assess the strategic resilience of a company, the draft annex to the non-binding guidelines for the reporting of non-financial information by the EU refers to the TCFD Technical Supplement „The use of scenario analyses to disclose climate-relevant risks and opportunities“.

The scenario analysis is not alien to the existing guidelines for reporting non-financial information. Located in the area of performance indicators, these already provide that a company - taking into account its specific situation - could disclose information on the climate-related effects of its business activities and strategy and supplement this with suitable probability assessments and scenario analyses.

On November 8, 2015, the New York Attorney General concluded a settlement agreement with Peabody Energy Corporation („Peabody"), the world's largest listed coal company, regarding the company's climate change disclosure practices. The Settlement concludes a two-year investigation under the New York Martin Act that finds that Peabody's filings with the SEC and other public disclosures contain misleading statements about the potential impact of Peabody's future CO2 emission laws and regulations. Within the framework of the settlement, Peabody neither admitted nor contested the findings of the investigation, but agreed to make certain adjustments in the next quarterly report and to make further adjustments to disclosure practices in the future. In particular, the only selective presentation by Peabody of projections for future demand for coal made by the International Energy Agency (the ‚IEA', a leading authority for future global energy developments) was misleading, as Peabody only discussed projections based on the most favourable scenario based on the assumption that governments will not introduce new laws/measures to combat global warming

The Intergovernmental Panel on Climate Change („IPCC"), an institution of the United Nations (also known as the „Intergovernmental Panel on Climate Change"), provides sound work on scenario analysis. According to own statements, scientists worldwide compile the current state of climate research on its behalf and assess the latest state of knowledge on climate change on the basis of recognised publications. These prepare the IPCC's so-called „progress reports". For the 6th progress report, the so-called „Shared Socioeconomic Pathway („SSP") based RCPs" are supplemented. In this way, interactions can be included that correspond to the IPCC's concept of risk:



Source: IPCC, 2014: Summary for policymakers. In: Climate Change 2014: Impacts, Adaptation, and Vulne- rability. Part A: Global and Sectoral Aspects. Contribution of Working Group II to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change, page 3. Cambridge University Press.

So-called Shared Climate Policy Assumptions („SPAs“) also allow future laws and regulations to be taken into account. If the SPAs are further divided into existing and future laws and regulations, a peabody situation, i.e. the accusation of inadequate and selective reporting for scenario analysis, can be prevented.

2 OUTLOOK

According to today‘s understanding, the TCFD recommendations are not legally binding regulations, but have found their way into the - also non-binding - guidelines for the reporting of non-financial information of the EU and can be a helpful, very granular guideline for the fulfilment of the legally prescribed reporting (especially according to § 289c HGB).

Companies that recognise the added value of sound and robust climate-related reporting can look forward to emerging more stringent, mandatory climate reporting (in line with EU legislation that has taken up TCFD recommendations).

Various approaches exist to measure the impact of companies on climate change. According to one member of the TEG, these are still in their infancy, but should not be underestimated in the development of a standard, provided the necessary transparency is guaranteed. „Business transparency with regard to climate-related information is therefore already a worthwhile investment.

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