June 2021

Learning About **ESG**

The G7 and climate reporting

Learning About ESG is an educational series that connects **environmental, social and governance** topics with investing.

Join us each issue to see how global developments can have implications for investors. The better we understand ESG, the bigger the role it can play in our everyday lives – and investment portfolios – contributing to a better world.

Key takeaways

- The 47th **G7 Summit** was held in mid-June in the UK countryside. The Group of Seven is **an inter-governmental political forum** of nations that represent more than 40% of global GDP and close to 10% of the world's population.
- During the Summit, the G7 backed proposals on **company disclosures of climate-related risks**. Climate reporting can **provide investors the transparency** to evaluate the relevant climate risks and opportunities.
- Climate-related risks have the **potential to result in financial impact** for companies. These risks can come in the form of **physical risks** (attributed to weather) and **transition risk** (policy & legal, technological, market and reputational).

What is the G7 Summit?

The 47th G7 Summit was held during the second weekend of June in the United Kingdom. "G7" is an acronym for the **Group of Seven, an inter-governmental political forum** that consists of the UK (currently holding presidency), US, Canada, France, Germany, Italy and Japan. Together, **these countries represent more than 40% of global GDP and approximately 10% of the world's population**[1].

The G7 emerged in the 1970s as an informal gathering of finance ministers from Western Europe and North America, who came together **to form agreements and approaches to important global issues**. Over the years, the membership has expanded and shifted to include the world's largest advanced economies and wealthiest liberal democracies.

Along with representatives from the European Union and observers from other leading economies, the G7 meets at annual summits hosted by the nation occupying the annually-rotating presidency.

Over the past decade, **key topics of discussion at the summits include**:

- Financial stability
- Geopolitical challenges
- Nuclear security
- Climate change
- Global health
- Tax

Image 1 – Sculpture from the G7 Summit held in Lyon, France

During the 2021 G7 Summit, the leaders had one objective to help the world combat and **build back better from the coronavirus and to create a greener, more prosperous future**.

Image 2 – Aerial view of Carbis Bay, St Ives, Cornwall, UK (site of the 2021 G7 summit)

Many measures were discussed to **address the climate crisis and protect nature** with leaders reaffirming their commitment to the Paris Agreement, including **policies around phasing out coal burning, reducing emissions from energy, transport, heavy industry and investing in carbon capture technology**.

One significant outcome was the 'Build Back Better for the World' partnership proposed by the US. This aims to **bring together G7 countries to provide financing for vital infrastructure** – from railways in Africa to wind farms in Asia. The initiative is intended to give developing countries access to more, better and faster finance, while **accelerating the global shift to renewable energy and sustainable technology**.

1. "G7 summit: What is it and why is it in Cornwall?", BBC.co.uk

Climate reporting was discussed at the Summit, but why is it relevant to investors?

With climate change penetrating through all levels of society, there is an **increasing demand from investors and regulators for companies to consider the environmental impact on their businesses**. This is commonly done via company disclosures and reporting that may influence investors' confidence[2]. Since 2003, the number of companies providing climate-related disclosures have grown by more than 40x (see Figure 1).

The G7 also backed proposals on **company disclosures of exposure to climate-related risks, a measure seen as vital to safeguard the financial system from climate change shocks**. In June, the G7 Finance Ministers also called on more unified efforts to:

- Measure corporate impact on the climate and environment
- Generate awareness on the risk of fragmentation as local jurisdictions adopt different approaches

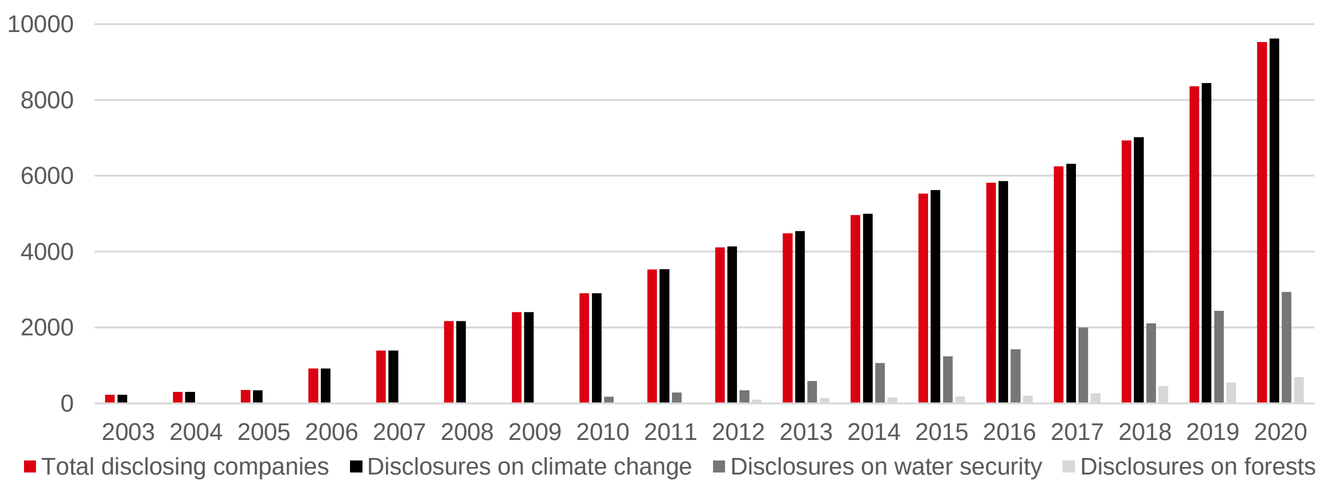
These recommendations are **in line with the Task Force on Climate-related Financial Disclosures (TCFD), a robust global framework for climate-related financial disclosure**.

TCFD-aligned disclosures offer investors specific information on a company's climate risks, corporate governance and accountability. For the company itself, they also provide a mechanism to integrate climate risks into risk management and business strategy. As such, **investors are provided with the transparency they need to evaluate the relevant climate risks and opportunities**.

More than 1,500 companies today support the TCFD's recommendations, including corporates with a combined market cap of USD13 trillion and investors with USD140 trillion of assets under management collectively. As of Nov 2020, **the UK was the first major economy to confirm plans to mandate climate disclosure**.

In addition, the G7 Finance Ministers also backed the International Financial Reporting Standards Foundation to **develop a new global standard for sustainability reporting**. They also endorsed the launch of the Taskforce on Nature-related Financial Disclosures, which is a new global market-led initiative **aimed to provide financial institutions and corporates with a complete picture of their environmental risks and opportunities**.

Figure 1: Growth in climate-related disclosing companies since 2003



Source: CDP.com

2. "Corporate reporting and climate change", Deloitte.com

What types of climate-related risks should investors be cautious of?

Climate-related risks affecting companies have the potential to result in financial impact just as other forms of risk do, such as market risk, reputational risk, and regulatory risk. Investors are beginning to use company disclosures on climate-risk (such as those made in line with TCFD) to identify, measure, and mitigate risk in their own investment portfolios.

The TCFD separates climate risk into **two categories: physical and transition risks**. The categories and severity levels of these risks are described in the table[3] below:

	Climate Risks	Description
Physical	Acute	Physical risks resulting from increased frequency and severity of weather events such as floods, droughts, and hurricanes
	Chronic	Physical risks resulting from longer-term changes in weather patterns and other climate change impacts
Transition	Policy & Legal	Risks from emerging regulation to address climate change and/or litigation risk
	Technological	Risks from disruptive and innovate technologies that are emerging to support the low-carbon transition
	Market	Risks resulting from shifts in supply and demand curves as economies and consumers react to climate change
	Reputational	Risks of damage to brand value resulting from changing public sentiment related to climate change

Glossary

ESG disclosure: data released by companies on operations and business impact in three areas: environmental, social and corporate governance; such information can aid investors to screen companies with greater financial risk from existing ESG practices

Group of Seven (G7): an inter-governmental political forum that consists of the UK (currently holding presidency), US, Canada, France, Germany, Italy and Japan.

Task Force on Climate-related Financial Disclosures (TCFD): a robust global framework for effective climate-related financial disclosures; aim of the disclosures is to promote more informed investment decisions and enable a better understanding of carbon-related assets in the financial sector and system's exposures to climate-related risks.

3. "Clarity in financial reporting: Disclosure of climate-related risks", Deloitte

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