Carbon Tracker Initiative, Inc
142 W 57th Street, 8th Floor
New York, NY 10019

Task Force on Climate-Related Financial Disclosures
110 Corcoran Street
Durham, NC 27701

By email to info@fsb-tcfd.org

July 16th, 2021

Dear TCFD Secretariat,

TCFD Consultation on Proposed Guidance - Response from Carbon Tracker Initiative

We laud the TCFD's pioneering work on improving financial disclosure of climate-related risks and its dedication to this issue with the current consultation. As the TCFD is well aware, disclosures are not ends in themselves, but a means to an end—that end being the more accurate pricing of climate risk, which then leads to shifting capital allocation, smooth transformation of the real economy, and avoidance of sudden re-pricing events. Climate science tells us that all of this is desperately needed.

The current consultation reflects the reality that markets have not fully resolved how climate-related transition risk can be factored into investment decision-making. It notes three particular challenges:

- **First, current metrics lack clarity and comparability.** The consultation identifies "the lack of standardized industry metrics" as a key gap. Tools and metrics which lack transparency are difficult to trust and cannot yield comparable results across a range of portfolio constituents and/or asset classes.

- **Second, metrics must effectively measure financial impact.** The consultation emphasizes the need to create "alignment between climate-related metrics and targets and the elements of financial reporting." Money is the language of markets. For markets to ingest climate-related risks like any other risks, they must be monetized.

- **Third, the measure must address both transition planning and portfolio alignment in a forward-looking manner.** The consultation seeks to create understanding of the impact of "potential decarbonization pathways" and a means of assessing "portfolio alignment." Climate change shows that past cannot be prologue; investors need an understanding of both the financial risk to portfolios and their constituents and a means of understanding whether those entities are aligned with decarbonization targets.

Carbon Tracker's submission, as detailed in the attached discussion paper, proposes a key starting point for addressing these three challenges: Carbon Quotient (CQ). What is CQ?

- First, it is an open-source toolset for producing carbon-adjusted financial accounts that can be applied across asset classes and portfolios, based on three transparent and replicable sets of information: (1) verified financial accounts, (2) carbon emissions, and (3) a single imputed carbon expense applied across the accounts. The clarity and transparency of the approach allows its outputs to be easily understood and reproduced. CQ also yields a normalized financial ratio (defined below) that fosters comparability across asset classes and across the investment value chain.
- Second, CQ links monetized emissions to their financial source – the carrying value of emission-producing assets, and estimates future emissions based on the remaining useful lives of those assets. By applying a uniform imputed carbon expense—an approximation of the cost to remove emissions from the atmosphere, CQ generates a universally applicable, forward-looking projection of climate-related asset impairment risk. CQ treats all assets the same by pricing a hypothetical net zero scenario in which all entities are responsible for fully offsetting their carbon emissions *today*.
- Third, CQ recognizes that achieving net zero emissions by 2050 will require decarbonization of the existing capital asset base on an accelerated basis. Relying on a transparent mapping to net zero emissions, CQ can compare alignment of portfolios and constituents to a net zero pathway over time, clearly differentiating between carbon leaders and laggards.

The key CQ inputs are defined here:

The *Carbon Quotient ratio* is defined as:

$$Carbon\ Quotient = \frac{Unrealized\ carbon\ expense}{Assets}$$

Unrealized carbon expense is:

Unrealized emissions (tCO_2e) times an imputed carbon price ($\$/tCO_2e$)

Unrealized emissions are:

future emissions (tCO2e) that will result from the continued use of emission-producing physical *assets* over their remaining life, calculated as current period *realized emissions* times *asset life*

Assets are:

the carrying value (cost less accumulated depreciation, depletion and amortization) of emission-producing physical assets; and

Asset life is:

assets divided by current period depreciation, depletion and amortization expense

As discussed in the paper in detail, CQ is a constituent-level and portfolio-level toolkit with financial ratios and sub-ratios that can form the starting point for more detailed financial analysis. By building on the existing audited financial statements, it allows financial analysts to integrate climate-related risks into their fundamental analysis, generating the virtuous cycle that can bring future harms into present-day investment decision-making.

We thank the TCFD for its continued attention to these issues and hope that CQ can be a useful contribution to the discussion.

Yours sincerely,

Rob Schuwerk
Executive Director, Carbon Tracker North America