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CLIMATE-RELATED DISCLOSURES: DO THEY FIT THE EU AGENDA?

#CLIMATEDISCLOSURESEU

WELCOMING REMARKS

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European Commission

Guidelines on reporting climate-related information

4 July 2019

Banking and finance

The Non-Financial Reporting Directive

4 issues

- Environment
- Social & employee
- Human rights
- Bribery & corruption

5 areas

- Business model
- Policies and due diligence
- Outcomes
- Risks and risk management
- KPIs

Large listed companies, and banks and insurance companies, with >500 employees

Materiality: "to the extent necessary for an understanding of the undertaking's development, performance, position and impact…"

European Commission

Non-Binding Guidelines - 2017

6 principles

- Material
- Fair, balanced and understandable
- Comprehensive but concise
- Strategic and forward-looking
- Stakeholder oriented
- Consistent and coherent

Guidance and examples for

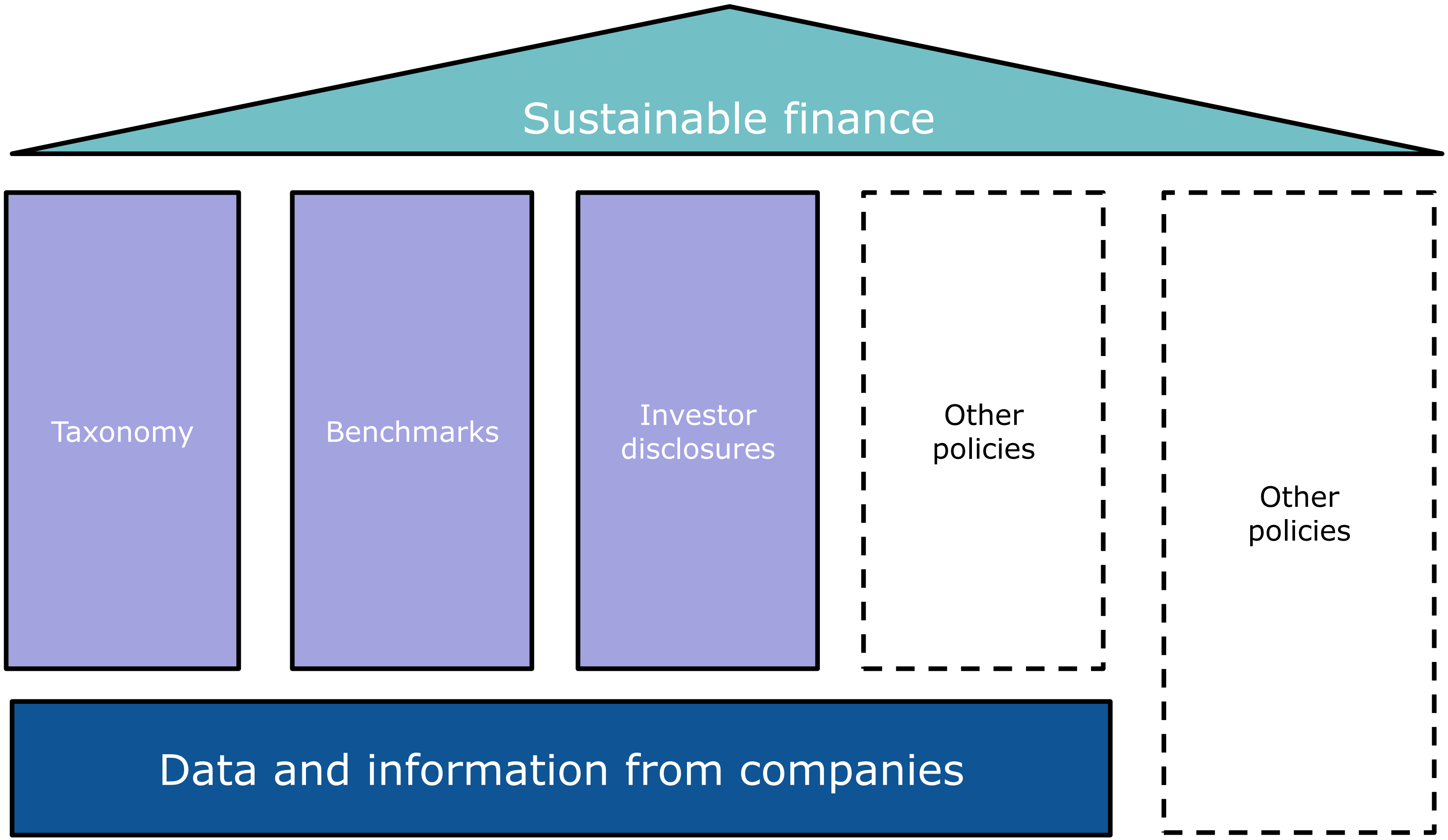
each of the 5 disclosure areas
(business model, policies etc)

&

each of the 4 issues
(environment, social, etc)

Flexible, not prescriptive, light-touch

Sustainable finance requires good climate reporting



Current company climate reporting is inadequate

Only 14 of the 89 companies (approximately 16%) devote attention to the TCFD recommendations and apply them to some extent.

Dutch Authority for Financial Markets, December 2018

TCFD Status Report 2019

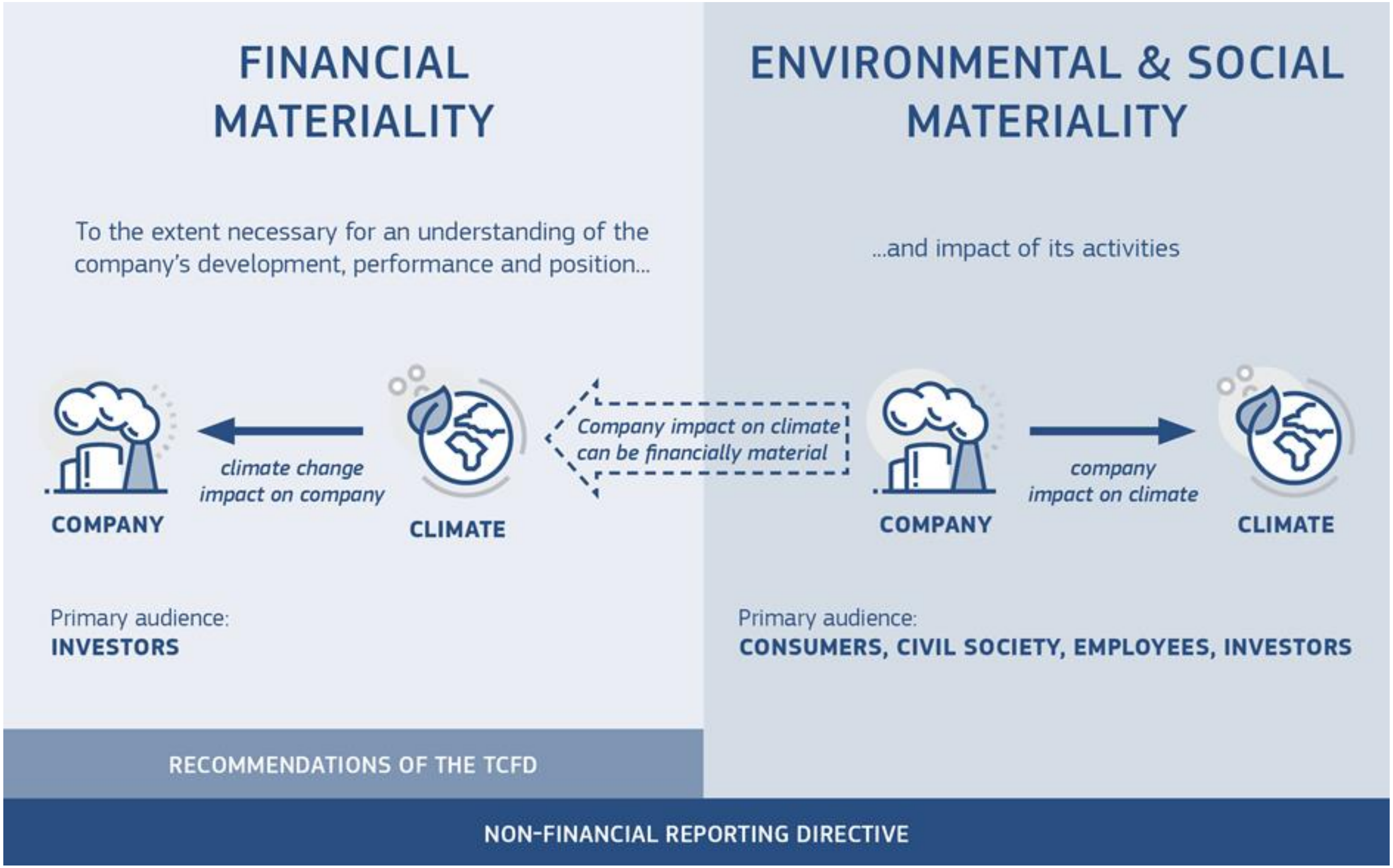
"The Task Force […] is concerned that not enough companies are disclosing decision-useful climate-related financial information." Only around 25% of companies disclose information aligned with more than five of the 11 TCFD recommended disclosures.

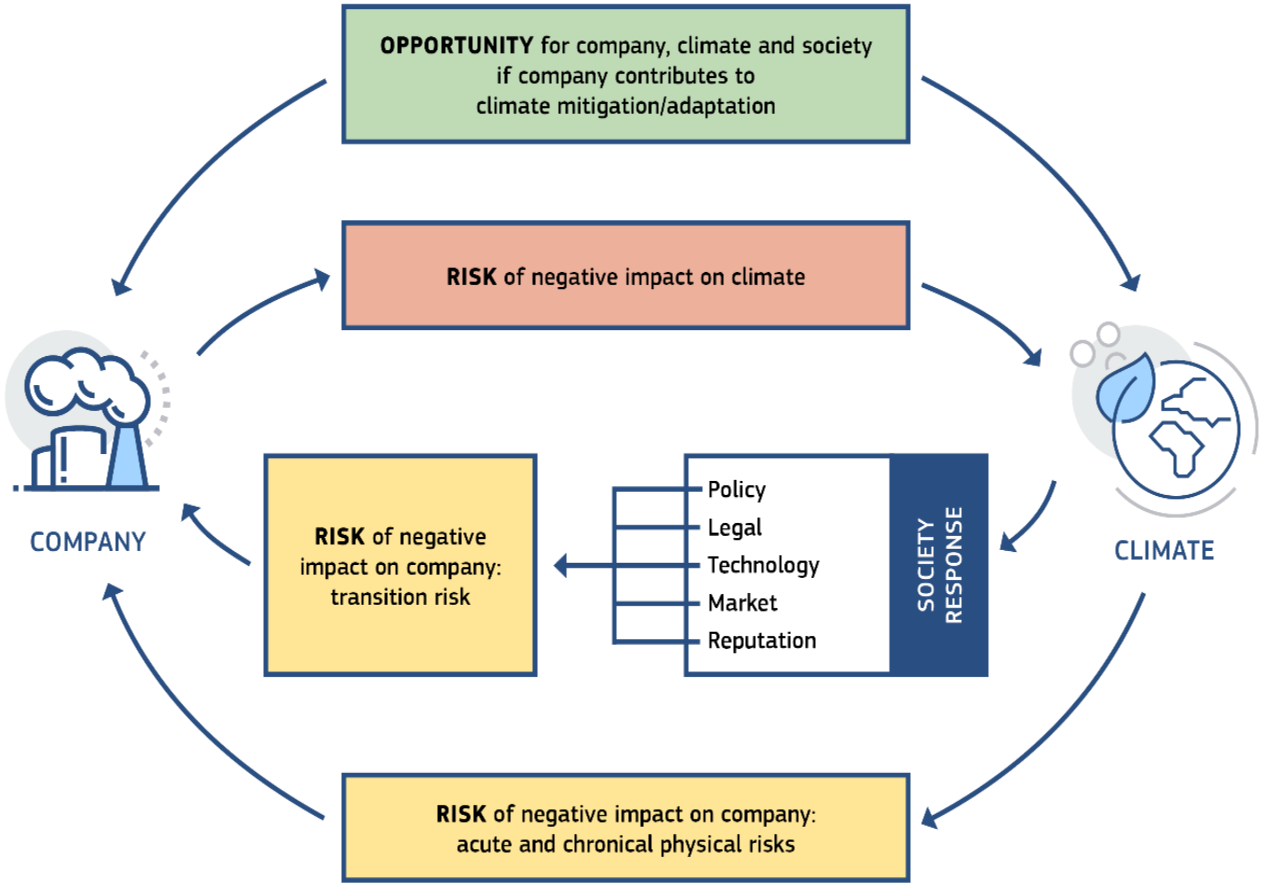
Only 50% of a sample of 105 large companies specified clearly what their climate policy has been designed to achieve and how.

Alliance for Corporate Transparency, 2018

Key features of the guidelines on climate reporting

- Consistent with Non-Financial Reporting Directive.
- Supplement to general guidelines on non-financial reporting published in 2017, which still apply.
- Integrate TCFD recommendations.
- Based on proposals from the Technical Expert Group on Sustainable Finance.
- Target audience: the +/- 6,000 listed companies, banks and insurance companies under the scope of the Non-Financial Reporting Directive.
- Not legally binding.


FINANCIAL MATERIALITY
ENVIRONMENTAL & SOCIAL MATERIALITY
To the extent necessary for an understanding of the company's development, performance and position...
...and impact of its activities
COMPANY
climate change impact on company
CLIMATE
Company impact on climate can be financially material
COMPANY
company impact on climate
CLIMATE
Primary audience:
INVESTORS
Primary audience:
CONSUMERS, CIVIL SOCIETY, EMPLOYEES, INVESTORS
RECOMMENDATIONS OF THE TCFD
NON-FINANCIAL REPORTING DIRECTIVE


OPPORTUNITY for company, climate and society
if company contributes to
climate mitigation/adaptation
RISK of negative impact on climate
COMPANY
CLIMATE
RISK of negative impact on company: transition risk
Policy
Legal
Technology
Market
Reputation
SOCIETY RESPONSE
RISK of negative impact on company: acute and chronical physical risks

European Commission

Structure of guidelines

5 reporting areas of the Non-Financial Reporting Directive

Business model | Policies | Outcomes | Risks | Indicators

13 recommended disclosures and 10 KPIs
indicating which ones are TCFD recommended disclosures

Further guidance
+ specific further guidance for banks and insurance companies

Mapping the Non-Financial Reporting Directive and the TCFD

TCFD Recommended Disclosures		NFRD Elements				
		Business Model	Policies and Due Diligence Processes	Outcomes	Principal Risks and Their Management	Key Performance Indicators
Governance	a) Board's oversight		■			
	b) Management's role		■			
Strategy	a) Climate-related risks and opportunities				■	
	b) Impact of climate-related risks and opportunities	■				
	c) Resilience of the organization's strategy	■				
Risk Mgmt.	a) Processes for identifying and assessing				■	
	b) Processes for managing				■	
	c) Integration into overall risk management				■	
Metrics & Targets	a) Metrics used to assess					■
	b) GHG emissions			■		
	c) Targets			■		

What next?

- *Outputs of first project of European Corporate Reporting Laboratory*
- *Fitness Check on corporate reporting*
- *Revision of the Non-Financial Reporting Directive…?*

REACTIONS

Eric Dugelay

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Deloitte.

Leveraging climate change disclosures

The opportunity brought by the TCFD

Meeting at Accountancy Europe, Eric Dugelay, Brussels, 4 July 2019

Content

- Climate change on top of the sustainability agenda
- Focus on the TCFD - What we have seen and what we foresee
- Climate change disclosures - The ultimate output of a robust scenario analysis process

Climate change on top of the sustainability agenda

Climate change is perceived to generate the most important risks for the global economy

One illustration : the World Economic Forum 2019 Global Risks Report

- Three of the top five risks to the global economy are environmental risks.
- Survey respondents are increasingly worried about environmental policy failure: having fallen in the rankings after Paris, "failure of climate-change mitigation and adaptation" jumped back to number two in terms of impact this year.
- The results of climate inaction are becoming increasingly clear. The accelerating pace of biodiversity loss is a concern.
  - Species abundance is down by 60% since 1970.
  - In the human food chain, biodiversity loss is affecting health and socioeconomic development, with implications for well-being, productivity, and even regional security.
- According to UN Environment, issuance of "green bonds" jumped from US$11 billion in 2013 to US$155 billion in 2017.

Categories

Economic Environmental Geopolitical Societal Technological

Top 10 risks in terms of **Likelihood**	Top 10 risks in terms of **Impact**
1. Extreme weather events	1. Weapons of mass destruction
2. Failure of climate-change mitigation and adaptation	2. Failure of climate-change mitigation and adaptation
3. Natural disasters	3. Extreme weather events
4. Data fraud or theft	4. Water crises
5. Cyberattacks	5. Natural disasters
6. Man-made environmental disasters	6. Biodiversity loss and ecosystem collapse
7. Large-scale involuntary migration	7. Cyberattacks
8. Biodiversity loss and ecosystem collapse	8. Critical information infrastructure breakdown
9. Water crises	9. Man-made environmental disasters
10. Asset bubbles in a major economy	10. Spread of infectious disease

Source: World Economic Forum Global Risks Perception Survey 2018–2019

Climate Change and businesses

The difficulties to identify the extent of the impacts

- A physical risk is an uncertain event or condition that, if it occurs, can cause significant negative impact for several countries or industries within the next 10 years. When speaking about physical risk, both incremental impacts and extreme events are included.

- "Failure of climate-change mitigation and adaptation" has a significant impact and high likelihood. (1)

(1) Source : World Economic Forum

Physical risk

- To stimulate a low-carbon transition, governments will need to take actions, for example by implementing cap and trade markets or ramping up fuel efficiency standards. Such actions will naturally impact the economy.

- In the future, policies, technologies and society will continue to evolve, resulting in a changing set of impacts across industries.

Transition risk

- A non-linear change is a change that is not based on a simple proportional relationship between cause and effect. Nonlinear changes are often abrupt, unexpected, and difficult to predict ("Tipping Points").

- Climate effects can amplify each other, greatly increasing exposure and limiting options to respond. (2)

(2) Source : UNEP-FI

Non linearity

Focus on the TCFD

What we have seen and what we foresee

TCFD second status report - Themes and Findings

The Task Force found some of the results of its disclosure review and survey encouraging, however, it has concerns that not enough companies are disclosing decision-useful climate-related information.

Disclosure of climate-related financial information has increased, but is insufficient.

Progress is being made to improve the availability and quality of climate-related financial information; however, more companies need to consider the potential impact of climate change and disclose material findings.

Many companies that use scenarios do not disclose information on strategy resilience.

Three out of five companies responding to the TCFD survey that view climate-related risk as material and use scenario analysis to assess the resilience of their strategies do ***not*** disclose information on the resilience of their strategies.

More clarity needed on potential financial impact of climate change on companies.

The top area identified by investors and other users of disclosure as needing improvement is for companies to provide more clarity on the potential financial impact of climate-related issues on their businesses.

Mainstreaming climate-related issues requires the involvement of multiple functions.

While sustainability and corporate responsibility functions are the primary drivers of TCFD implementation efforts, risk management, finance, and executive management are increasingly involved as well.

Disclosures are made in multiple reports and vary across industries and regions.

Companies provide information aligned with the TCFD recommendations in multiple types of reports– financial filings, annual reports, and sustainability reports. In addition, the types and levels of disclosure vary across industries and regions.

TCFD second status report – Next steps

The Task Force is considering additional work in the areas described below and possibly in other areas in the coming months.

- Developing process guidance around how to introduce and conduct climate-related scenario analysis
- Identifying business-relevant and accessible climate-related scenarios
- Clarifying elements of the Task Force's supplemental guidance contained in the annex to its 2017 report
- Developing a third TCFD status report (September 2020)

Climate change disclosures

The ultimate output of a robust scenario analysis process

Building a scenario-based analysis

A key step for answering TCFD recommendations

Many scenarios have been developed both on transition and physical risks. A scenario-based analysis would certainly use more than one scenario. Furthermore, the integration of both transition risk and physical risk in the same methodological framework would require a conceptual adaptation.

Existing scenarios

IEA World Energy Outlook — *New policies scenario, current policies scenario, sustainable development scenario,…*

IPCC scenarios — *AR5 RCP8.5, AR5 RCP6.0, AR5 RCP4.5,…*

Private sector scenarios (Shell, Exxon,..) — *New Lens scenarios (Mountain and Ocean), Evolving Transition scenario, Faster transition scenario,…*

Difficulties in applying public scenarios:

- *Macro and global assessment for policy makers and scientists*
- *Not fitted for a business or investment context*
- *Misinterpretation of non-linear changes*

It is **usually necessary to consider various scenarios**. Once selected, these scenarios **have to be adapted to each activity of the assessed business**. **A key point for a company conducting this kind of assessment is to understand underlying assumptions of picked-up scenarios.**
Typically, physical and transition risks are considered separately as their drivers, temporality and sensitivity are different.

Beyond existing scenario-based models

Companies need to use an adapted methodology for their own scenario development

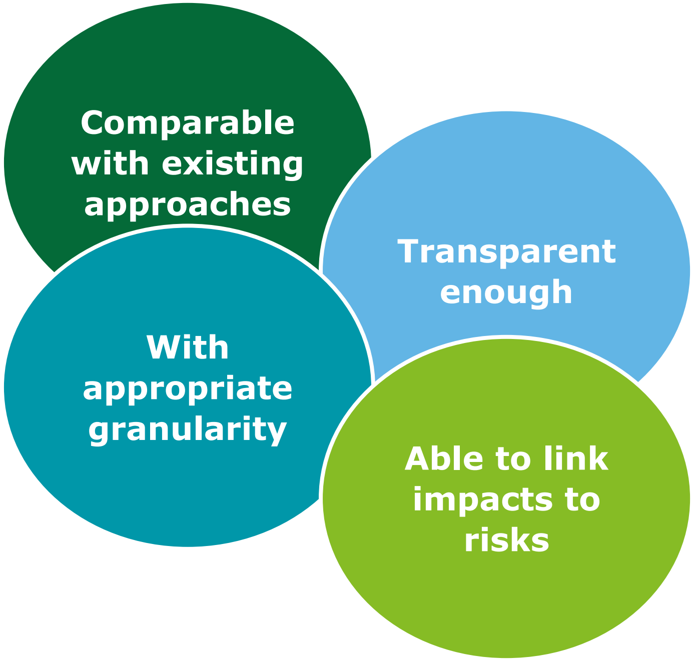
The objective of scenario-based analysis is to assist in a better understanding of :

- **The degree of robustness** of the organization's strategy and financial plans under different plausible future states of the world;
- **How the organization may be positioning itself** to take advantage of opportunities and plans to mitigate or adapt to climate-related risks;
- **How the organization is challenging itself** to think strategically about longer-term climate- related risks and opportunities.

Key characteristics of scenario analysis

- ***Plausible***
- ***Distinctive***
- ***Consistent***
- ***Challenging***
- ***Relevant***

Key features of the methodology

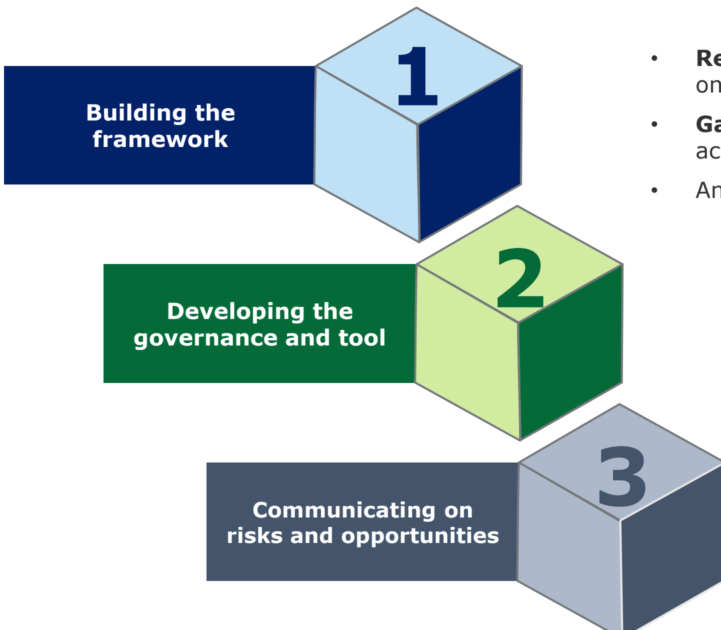


Typical approach

What it takes to operationalize a suitable approach of climate related risks assessment

Operationalize this kind of approach in a company is mainly a matter of framework building. If internal knowledge and skill would probably need to be completed by external expertise, the design of an appropriate governance, able to mobilize key stakeholders and resources is the very first step towards answering TCFD recommendations.

Methodology implementation steps



Main tasks

- **Review publicly available scenarios** to select the most appropriate ones
- **Gather information on climate risks** and their impact on economic activities (with a regional breakdown if appropriate)
- Analyze company's activities to **define a consistent segmentation**

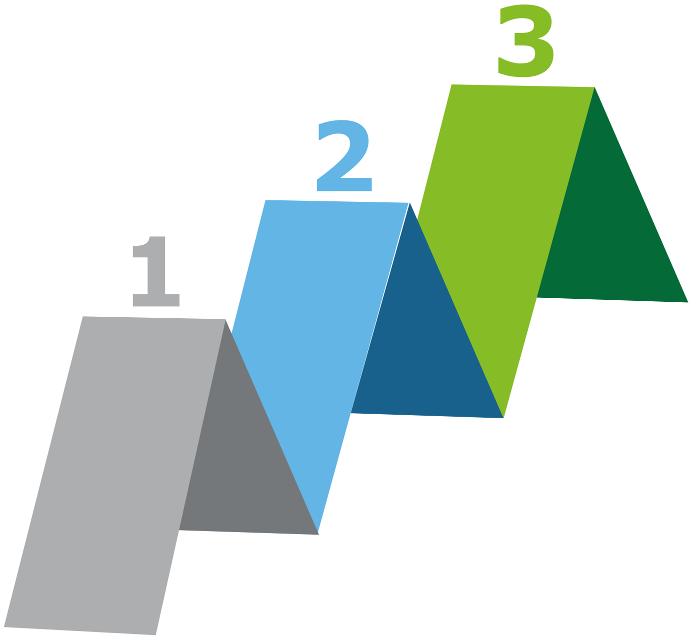
- Design an efficient **process for expert consultation**
- **Elaborate a systematic tool** leading to a repeatable, updatable and scalable risk & scenario analysis process
- **Define the appropriate governance** process for the approach

- **Identify key outputs** of the assessment
- **Draft a climate disclosure report** according to TCFD recommendations
- **Summarize key findings** and the way forward, including any uncertainties and/ or areas for further investigation

Climate change disclosures - The ultimate output of a robust scenario analysis process

Taking a step back, what are companies' real benefits using this approach?

It is an iterative exercise: the first report is intended in particular to generate reaction (internally), to reveal gaps and to initiate possible corrective actions. Beyond the simple wish to comply with the recommendations of the TCFD, there are multiple benefits:



3- Communication

Like any publication of information in an annual report, the ultimate objective is to highlight the competitive advantages of the company (resilience, ability to seize opportunities ...)

2- Risk Analysis

Scenario analysis provides a partly quantitative understanding of climate risks, and thus a more organized approach to corrective actions

1- Internal awareness

Stakeholder consultation and validation by management are strong levers of internal awareness, both to think about how to understand the risks and to convince management to leverage on opportunities

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STAKEHOLDER DISCUSSION

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