Global Compact Network UK

Task Force on Climate-related Financial Disclosures Working Group

2021-2022 Annual Summary Report

Over the last two years, the UN Global Compact Network UK's Task Force on Climate-related Financial Disclosures (TCFD) Working Group (WG) explored topics related to TCFD to understand ongoing policy developments, tackle challenges and solutions, and support best practices for implementation of the recommendations. In 2022, the WG also looked at reporting trends, pitfalls, and good practices from previous reporting cycles.

The TCFD Working Group held eight virtual meetings between April 2021-December 2022, during which experts and members shared their insights, experiences, and learnings on TCFD reporting. The meetings covered the following:

1. Financial Conduct Authority guidance on TCFD-aligned disclosures 1
2. Good practice disclosures from an investor perspective 3
3. Quantifying climate risk and opportunity 5
4. TCFD Assurance 6
5. UK Sustainability Disclosure Requirements (SDRs) 7
6. Reporting trends from 2021 9

This report summarises the key learnings from these meetings.

1. Financial Conduct Authority guidance on TCFD-aligned disclosures

The Financial Conduct Authority (FCA)'s sustainable finance strategy and work on TCFD centres on five themes:

- **Transparency:** to promote good disclosures along the investment chain, with TCFD playing a critical role in this.
- **Trust:** to ensure the market delivers sustainable finance products and services that meet investor and consumer preferences while avoiding greenwashing.
- **Tools:** to allow government, regulators, and industry to develop tools and resources and work together to confront climate change.
- **Transition**: to intervene where necessary to underpin a market-led transition to a more sustainable future.
- **Team**: to embed ESG considerations and net zero into internal FCA procedures, and act as a role model for other organisations.

Listing Rules

The FCA published a Policy Statement in December 2020 that outlined a new Listing Rule, including a technical note identifying where issuers currently need to make climate-related or ESG disclosures. The Listing Rule requires UK premium-listed commercial companies to include a statement in their annual financial report setting out:

- Whether they have made disclosures consistent with the TCFD's 11 recommended disclosures in their annual financial report.
- Where they have not made such disclosures, an explanation of why, and a description of any steps they are taking or plan to take to be able to make consistent disclosures in the future.
- Where they have not made their disclosures in their annual financial report, an explanation of why, and where they have disclosed.

Alongside the Rule, the Policy Statement includes guidance on when it may be more reasonable to explain non-compliance rather than disclose, for example, if the company is undergoing transitional challenges. It was also noted that the level of detail in disclosures should correspond to the nature, size, and business profile of the company, as well as the robustness of its climate strategy. In December 2021, the FCA published two further Policy Statements, the details of which are outlined below.

Following the establishment of the UK's Transition Plan Taskforce (TPT) at COP26, the 2021 Policy Statements also introduced rules for listed companies and large regulated asset owners and asset managers to disclose transition plans as part of their TCFD-aligned disclosures. The first disclosures under these rules will be made in 2023. In November 2022, the TPT released a draft Disclosure Framework and accompanying Implementation Guidance, which are currently open for consultation and aim to be finalised in 2023 to guide companies in publishing high-quality plans that comply with the Listing Rule.

The FCA recommends that TCFD disclosures be a part of mainstream financial filings to promote the integration of financial reporting with climate policy. In this way, both the climate strategy and its effect on financials can be delivered together. The FCA also recommends a general "core and more" approach to disclosures – including core information in an Annual Report, while encouraging elaboration in a standalone document released at the same time. This encourages a pragmatic approach for maintaining detailed disclosures while also ensuring consistency, comparability, and structure in the reports.

Roadmap to mandatory disclosures

FCA regulations are included as part of the wider UK TCFD implementation strategy outlined in the Government's Roadmap towards mandatory climate-related financial disclosures by 2025. The FCA and the Department for Business, Energy and Industrial Strategy (BEIS) have conducted several consultations on these topics over the past two years and will continue to do so as policies develop. In addition, the FCA, along with several other UK government agencies, supports the International Financial Reporting Standards (IFRS) Foundation and International Organization of Securities Commissions' (IOSCO) work towards a common international reporting standard (more information on this topic can be found in Section 4).

In July 2022, the FCA published its review of the first mandatory TCFD disclosures made by premium listed companies. The key observations are summarised below:

- Compared to 2020 (when reporting was done on a voluntary basis), there was an increase in partially or mostly consistent disclosures.
- There were fewer consistent disclosures than companies had self-reported.
- Reporting gaps were most common in relation to quantitative recommendations (e.g., those related to Scope 3 emissions).
- Level of detail and consistency in disclosures often correlated with sector, size, and company's assessment of climate risk.

Consumer Trust

A key objective for the FCA is to build trust in the funds market and wider ESG ecosystem. According to survey evidence, 85% of consumers feel as though they do not know who to trust in the ESG and sustainable funds market, and there are growing concerns that firms may be making exaggerated, misleading, or unsubstantiated sustainability-related claims.

Therefore, the FCA is undertaking the following regulatory actions to help consumers better navigate the market:

- In June 2022, it published its Feedback Statement on ESG integration in capital markets, highlighting the following:
  - The clear rationale for more regulatory oversight of ESG data/ratings.
  - The importance of aligning with IOSCO recommendations for global coherence.
  - That the FCA will continue to engage with HM Treasury and encourage a voluntary Code of Conduct to be established.
- In November 2022, the FCA announced the formation of an industry-led (IRSG/ICMA) and industry-owned Code of Conduct group to help promote the rapid development of best practices for ESG ratings and data providers.
- The FCA is currently engaging with HM Treasury on potential upcoming regulation focusing on:
  - Transparency
  - Good governance
  - Management of conflicts of interest
  - Robust systems and controls

Additional Resources

FCA's December 2021 Policy Statements – Following the December 2020 Policy Statement, the FCA released two further statements confirming final rules and guidance to promote better climate-related financial disclosures. It outlines that issuers of standard listed shares, or equity shares represented by certificates (global depositary receipts), must include a statement in their annual financial reports detailing whether their disclosures meet the TCFD recommendations. Additionally, FCA-regulated asset managers and asset owners – including life insurers and pension providers – will have to disclose how they take climate-related risks and opportunities into account when managing investments. These rules came into effect on January 1, 2022.

UK Government's Roadmap towards mandatory climate-related financial disclosures – The Roadmap sets out an indicative path towards mandatory climate-related disclosures across the UK economy. It outlines a timeline for implementation and the incremental steps to full compliance.

2. Good practice disclosures from an investor perspective

Investor Perspective and Expectations

TCFD has helped companies link evolving macroeconomic conditions from climate change and the net zero transition to the future financial performance of the company. This is crucial for investors as it allows them to quantify risks and understand how to mitigate them.

Companies may consider these points when recognising how investors view their disclosures:

- Although there is no mandate for how TCFD should be governed within a company, investors will examine the level of integration of TCFD into the Board structure.
- Investors may pay particular interest to companies receiving external advice or guidance, as this indicates their commitment to thorough TCFD integration.
- A business' direct and indirect corporate lobbying (for example, through membership in trade associations) should be aligned with the goals of the Paris Agreement.
- Short- and long-term net zero targets remain an important factor when analysing companies, but appropriate decarbonisation actions for reaching these targets must also be outlined.
- Investors are looking for detailed scenario analyses to understand how the business will be affected by best- and worst-case outcomes of climate change, including a 1.5°C or well-below 2°C pathway, as well as several higher temperature scenarios.
  - A company can use their own methodology or third-party tools for scenario analysis, but either way, investors want to see that companies are identifying how climate change will impact their business and that they are preparing for it.

Investors may also use the Climate Action 100+ Net-Zero Company Benchmark which outlines 10 criteria to "evaluate company ambition and action in tackling climate change". These criteria will continue to evolve and expand, with the addition of sector-specific analyses expected in the coming months. The Institutional Investors Group on Climate Change (IIGCC), one of the five network investor groups in the Climate Action 100+, publishes resources such as investor expectation papers and decarbonisation guidance for various sectors that may help companies align with these criteria. Additionally, companies may look to ArcelorMittal's Climate Action Report for an example of good disclosure practices from an investor point of view.

While investors expect thorough reporting, they are also looking beyond this to ensure that the company has a robust climate strategy in line with the goals of the Paris Agreement. For this reason, they may assess a company based on other factors that contribute to a more holistic view of the company's disclosures.

Climate Financial Risk Forum

Introduced in 2019, the Climate Financial Risk Forum (CFRF) was established by the FCA and the Prudential Regulation Authority (PRA) as an industry forum to share and develop best practice in disclosures. Phase 1 of the CFRF had four working groups: Disclosures, Scenario analysis, Risk management, and Innovation, with mixed representation from asset managers, banks, and insurers, among others. The output of the working groups is to provide advice for the financial sector, and while it is not regulatory in nature, the FCA has used the guidance to shape its thinking on regulation. Phase 1 produced a guide with four chapters in June 2020, Phase 2 ended in October 2021, resulting in several outputs, and Phase 3 began on April 27 2022, which introduced a working group focused on the transition to net zero.

Additional Resources

ArcelorMittal's Climate Action Report – This report, published in 2018, illustrates some best practices for climate-related financial disclosures from an investor perspective. In particular, it includes the quantification of financial impacts on capital expenditures and operating expenses, the timeframes over which this would occur, and the level of uncertainty.

Climate Action 100+ Net-Zero Company Benchmark – This benchmark was launched in March 2021 to assess companies' performance against the initiative's three high-level goals: emissions reduction, governance, and disclosure. Investors can use this information to monitor

progress, inform engagement strategies and decisions, and assess the alignment of company decarbonisation strategies with the goals of the Paris Agreement. The assessments of the 166 focus companies were released in March 2022.

Climate Financial Risk Forum Guide 2020: Disclosures Chapter – This document is the output from the cross-industry Disclosures Working Group of the CFRF. Published in June 2020, the guide includes three other chapters on Innovation, Scenario Analysis, and Risk Management and provides advice written by industry, for industry. This chapter provides practical recommendations for financial institutions wishing to meet good practice expectations for public climate-related financial disclosures.

Partnership for Carbon Accounting Financials (PCAF) – A useful tool for producing sophisticated metrics that allows companies to measure and disclose the greenhouse gas (GHG) emissions of loans and investments.

3. Quantifying climate risk and opportunity

Climate change may present both physical risks (i.e., increased frequency and severity of storms and drought) and transition risks (i.e., carbon taxation and consumer expectations) to companies, as well as opportunities for business improvement such as greater investment returns, cost savings, and reputational benefits. The 2017 TCFD Recommendations outlines several examples of climate-related risks and opportunities. It is important to be able to quantify these impacts in financial terms for reporting purposes.

The following steps can be followed to derive financial impact from a specific risk:

1. Hazard – Start with a single risk and identify the potential resulting hazard.
2. Effect – Assess how that hazard affects the business. This may also help with identifying the colleague(s) and/or team(s) responsible for the risk.
3. Impact – Identify and consider the impacts of the hazard. This may already become apparent during the previous steps.
4. Cost – Consider how much each impact would cost your business, both now and in the future. At some point it may become the case that the cost to respond now is less than the cost to react. This is sometimes referred to as regret analysis.

As an example, a heavy precipitation event (Hazard) may cause damage to company facilities (Effect), which leads to incurred costs for repair and maintenance (Impact). This can then generate increased insurance premiums (Cost), which can be easily quantified and reported.

A useful way to start estimating the financial impact of climate-related risks is by defining your short-, medium-, and long-term time frames. It is suggested that businesses should define these time frames according to the life of their assets, the profile of the climate-related risks they face, and the sectors and geographies in which they operate.

Uncertainty is unavoidable when estimating financial impact but can be accounted for in estimations by using error bars and considering the worst-case scenario for each impact. To address uncertainty and respond to any potential risks that may occur, clear governance structures and risk management processes should be in place.

Overall, the recommended approach to quantifying climate risk and opportunity includes the following:

- **Climate screening** – Identify climate risks and opportunities across business operations and the value chain, including determining which are material to the business and where the impacts could be felt.

- **Scenario analysis** – Understand the financial impact of climate under different climate scenarios (for example in 1.5°C, 2°C, and 4°C worlds). As mentioned above, it is beneficial to assess costs both now and in the future. Worst case scenarios and uncertainty should also be considered in scenario analysis.
- **Climate strategy** – Build adaptative management processes, demonstrate resilience, and maximise opportunities with a climate strategy. Engaging multiple stakeholders across the business can be useful in formulating these climate-related processes.

Additional Resources

Climate Scenario Analysis: Current Practice and Disclosure Trends – This report released by the Financial Reporting Council (FRC) and Alliance Manchester Business School outlines the processes companies use to produce their scenario analyses, and the motivations for doing so. It also examines best practices for several aspects of their analyses and how these have been integrated into business operations.

Intergovernmental Panel on Climate Change (IPCC) Reports – IPCC Reports, particularly Climate Change 2021: The Physical Science Basis and AR6 Climate Change 2022: The Mitigation of Climate Change, may be useful resources for understanding different climate scenarios, the science behind them, and how they impact business.

4. TCFD Assurance

It is important that companies publish non-financial information that meets a certain quality level and is presented in a thoughtful, detailed, and transparent way.

The International Standard on Assurance Engagements (ISAE) 3000 (Revised) is the assurance standard primarily used by accountants for non-financial information. This standard provides the framework to carry out assurance, and can be used for various kinds of information, processes, data sets, etc. In addition, ISAE 3410 is used for greenhouse gas statements.

ISAE 3000 has three main components:

- Appropriateness of subject matter – must be measurable, objective information.
- Suitable criteria (methodology) – can use external principles or can be developed within the organisation.
- Sufficient, appropriate evidence – it must provide enough information for an auditor to come to an assurance conclusion, either:
  - Reasonable assurance: equivalent to the outcome of a financial audit – considered 'positive' form of assurance.
  - Limited assurance: assurance provider understands the presented information and can conclude that it is plausible given how it was prepared – considered 'negative' form of assurance.

ISAE 3000 and ISAE 3410 are not the only assurance standards that can be used, but a suitable assurance method should consider six key criteria: relevance, competency, independence, terminology, methodology, and availability.

Effective disclosures and assurance considerations

Before seeking independent assurance, it is important that an organisation's disclosures already meet a high standard. Therefore, the first line of assurance should be done internally.

Companies can then decide if they require an advisory consultation before assurance, as this will result in a qualified opinion. Additionally, companies should be mindful to not disclose everything, but instead proportionally disclose information to the extent to which it is material. This will help the organisation to prioritise what needs to be assured as it is neither possible nor necessary to assure all information.

Effective disclosures should consider seven principles:

1. Relevance
2. Specific and complete
3. Clear, balanced, and understandable
4. Consistent over time
5. Comparable with other organisations within a sector, industry, or portfolio (TCFD issues guidance on this)
6. Reliable, verifiable, and objective
7. Timely

While it is a similar process to how an organisation would assure other datasets, TCFD disclosure assurance is also about the processes being described by the business. An assurance provider will look at company statements about governance, strategy, scenarios, etc. and then compare those to processes, structures, and controls in place to determine 'fair statement' assurance.

Because many aspects of TCFD disclosures are forward-looking, an assurance provider cannot say for certain that a strategy will be resilient or that a target/outcome will be achieved, only that they are reasonable/plausible. In these instances, cautionary statements that recognise uncertainty can be useful.

With regards to timing considerations, an assurance provider needs to have a robust understanding of all the components of a company's disclosures, so it is important to engage with them well ahead of when reporting needs to be published. Therefore, organisations must be careful to consider how assurance fits in with the rest of their reporting cycle.

5. UK Sustainability Disclosure Requirements (SDRs)

UK Green Taxonomy

In the lead up to COP26, the UK Government released a Greening Finance Roadmap outlining new Sustainability Disclosure Requirements (SDRs) for businesses. This included a proposed UK Green Taxonomy to establish a list of environmentally sustainable economic activities and support the financial services industry to effectively categorise investments and allocate capital towards 'green' projects.

The structure of the UK taxonomy, which will build on the EU taxonomy, is derived from activities listed in six environmental objectives: climate change mitigation; circular economy; climate change adaptation; pollution prevention; water and marine resources; and biodiversity and ecosystems. Once it is determined that a company's activities are deemed eligible within the detailed taxonomy criteria, it is likely that they will then be required to report on the percentage of their revenue, operating expenditures, and capital expenditures that align with the taxonomy. For this reason, companies, especially those with European subsidiaries, may be implicated by the proposed EU Corporate Sustainability Reporting Directive (CSRD). It is the intention that companies begin reporting on UK Green Taxonomy alignment in 2023/24, with requirements for investors and asset managers following after (unlike the roll out in the EU which introduced the requirements to all stakeholders at once).

Asset Management and Investment Products

The SDRs also contain three main components that will apply to all asset managers, including:

1. Product labelling – All investment products will be given a sustainability label depending on how they are managed and how the fund is invested.
2. Product-level sustainability disclosures – Informed by the new SDRs, these will likely be heavily quantitative and may include portfolio composition information and sustainability indicators and metrics that will have to be reported for each product.
3. Investment manager-level disclosures.

This regime is still in considerable development and is subject to change. In October 2022, the FCA released a Consultation Paper proposing to introduce a package of measures to clamp down on greenwashing, including sustainable investment labels, disclosure requirements, and restrictions on the use of sustainability-related terms in product naming and marketing.

Global Developments in Sustainability Reporting

These new UK policies fit within the wider global movement to standardise sustainability and climate-related reporting. Due to the established disconnect between what investors were asking for and what companies were required to report, the IFRS Foundation formed the International Sustainability Standards Board (ISSB) alongside the consolidation of the Climate Disclosure Standards Board (CDSB) and the Value Reporting Foundation (VRF), which houses the Integrated Reporting Framework and the Sustainability Accounting Standards Board (SASB). ISSB has developed two overarching reporting framework prototypes: one for general sustainability-related disclosures, as well as a supporting climate-specific standard. Both standards are heavily influenced by the TCFD recommendations but are structured around more granular information to provide formal, verifiable, and comparable information to investors and other stakeholders. At COP27, CDP pledged to integrate ISSB standards into its disclosure platform.

Additional Resources

UK Government's Greening Finance: A Roadmap to Sustainable Investing – Released in October 2021, this roadmap sets out the UK's ambition and strategy for greening the UK's financial system and laying the groundwork for sustainable investment to thrive. It functions in three phases: Informing, Acting, and Shifting. This document focuses on the first phase in this process, which introduces the UK's Sustainable Disclosure Requirements (SDRs).

ISSB's General Requirements for Disclosure of Sustainability-related Financial Information Prototype – The first of the ISSB's prototype frameworks released in November 2021, this document outlines a collection of draft requirements for financial disclosures related to any sustainability or ESG-related activities. This guide builds on components of six international reporting organisations, as well as the four pillars of TCFD: Governance, Strategy, Risk management, and Metrics and targets.

ISSB's Climate-related Disclosures Prototype – Also released in November 2021, this is a supporting prototype framework for the ISSB's general sustainability requirements. It centres on specific climate-related financial disclosures related to physical and transition risks from climate change, as well as climate-related business opportunities. ISSB plans to release further supporting thematic standards over time.

6. Reporting trends from 2021

Global consulting firms PwC and KPMG have both published insights based on their assessments of TCFD disclosures from the 2021 reporting cycle.

In May 2022, PwC released their report examining the disclosures of the first 50 FTSE 350 companies to report by 31 December 2021 under the TCFD's premium Listing Rules. The findings of the report were grouped into four areas, outlined below.

Risks and opportunities – business assessment

With regards to company judgments of their climate-related risks and opportunities, PwC looked for detailed risk assessments that outlined not only the steps in the process, but also who was involved, their expertise, the assumptions made, etc. They found that:

- Only 32% of companies provided a detailed disclosure of the risk assessment process carried out.
- There was a focus on the processes used to assess and manage risks, but little insight on the outcomes. For example, 86% of companies listed climate change as a principal risk, but only 4% stated whether it will be material in their financial statements.
- There was a lack of consistency across reporting. For example, only 28% of companies clearly linked risks and opportunities with metrics and targets.
- Disclosures were not driven by an assessment of risks and opportunities.

Risks and opportunities – business response

Once the material climate-related risks and opportunities have been identified, the next step is to lay out a clear plan or response to address them. The report highlighted that many companies defaulted to decarbonisation strategies, and in several cases, it was difficult to understand the connection between companies' responses to the risks, and the risks themselves. PwC identified that:

- Only 34% of assessed companies gave a clear plan and/or response to their identified physical and transitional risks, and only 38% set out timings for these plans.
- For the companies that set out carbon reduction goals, 56% disclosed milestones or interim targets for these commitments. While many companies set out 2025/2030 milestones, others left gaps between early interim targets and long-term 2040/2050 net zero goals. This is important to consider for transition plans, as it should be outlined what the company is relying on in that time gap (i.e., new technologies) to meet its targets.
    - Additionally, some of these requirements may change with the introduction of the ISSB regulation and the UK's Transition Plan Taskforce.

Reporting the 'F' in TCFD

Although PwC identified that 78% of companies mentioned climate change in their financial statements, they found that, generally:

- Disclosures were mainly brief and high-level.
- There was a lack of quantified financial impact disclosures – just 8% of companies quantified physical and transitional risks in their strategic report. However, many

others chose to disclose on this elsewhere. For example, 63% of companies quantified these risks in their CDP submissions.
- There is a potentially misjudged interpretation of material financial impact as only 10% of companies provided a link to the risks and opportunities in their annual report.
- The relationship between the operations and the financials isn't clear. Only 20% of companies had detailed disclosures in their financial statements, making the impact on their finances difficult to determine.

Listing Rule reporting

In terms of how well companies are aligning with the Listing Rule, PwC reported that there seemed to be some increased transparency in statements of consistency and acknowledgements of further required work. However, overall:

- There was a lack of clarity on consistency with the TCFD framework. For example, just 38% of companies claimed full consistency with the TCFD framework, and 50% said they have more work to do on their TCFD disclosures in the future.
- The quality of explanations was inconsistent with the TCFD framework – only 68% of companies provided an explicit statement of consistency.
- Companies are using other reporting channels to provide more detailed information; this is illustrated by 46% of companies including information outside of the annual report.
- Companies should exercise judgment and consider all aspects of the Listing Rules in their reporting.

In October 2021, TCFD published updated guidance on Metrics, Targets, and Transition Plans, which has now been integrated into the Listing Rule.

Improvements for 2022

KPMG released an insight piece on reporting trends from 2021, noting that while the learning curve on TCFD reporting is accelerating rapidly and good practices are emerging, there is still a way to go and important key lessons to be learned from the first TCFD reporting cycle.

Going forward into the next reporting cycle, companies should aim to:

- **Undertake scenario analysis using different time horizons and temperature scenarios** (i.e., 1.5°C, hot house scenario, third party benchmark, business as usual, Paris-aligned abatements) – this is key to stress-testing the sensitivity of variables used and helping companies identify their exposure to physical and transition risks over time, enabling the development of a well-informed strategic response. Companies should undertake point-in-time quantifications of climate risks and opportunities and disclose these externally.
- **Integrate climate risks and opportunities within firm strategy** – climate risk scenario analysis should inform the company's wider strategy, its climate ambitions, the level of investment required to mitigate those risks, and potential trade-offs with other strategic objectives. Climate risks should also be integrated into existing risk management and ERM frameworks, and internal processes for addressing those risks should be formalised and adopted within the company's governance architecture.
- **Expand metrics used** – companies should use quantitative and qualitative metrics that align with TCFD guidance and move beyond focusing solely on carbon emissions. This will help to improve data quality and accuracy when setting targets.

- **Engage with supply chains** – companies should strive to improve their Scope 3 emissions disclosures by engaging with organisations within their value chains.
- **Align with SBTi** – companies should align with SBTi guidance to improve their climate disclosures and focus on steps they can take to achieve targets from an early stage.
- **Quantify financial impacts** – companies should explain how different scenarios and the organisation's net zero commitments may affect the valuation of their assets and liabilities over time. Any assumptions or statements made in the front half of companies' Annual Reports and Accounts (ARAs) should follow through to their financial reporting. For instance, assumptions made about the implications of a carbon price should be reflected in the back end forecast of its revenue over time.

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