Investors Push the Pace of Climate Risk Financial Disclosures

May 2020

Yale Center for Business and the Environment

ERM

Executive Takeaways

An assessment of climate risk disclosures in three sectors (Oil and Gas, Energy Utilities, and Food and Agriculture) over three years indicates a rapid response amongst companies to shareholder expectations for greater information. The data and associated interviews reveal that leading companies are moving forward to better understand climate risk and disclose decision-useful information even as investors' expectations on the appropriate level of disclosure continue to evolve. The critical findings of the research include the following:

1. **The investor goal of climate risk comparability has not yet been achieved.** While the TCFD has created more organized thinking on climate risk disclosure, companies are using the TCFD and a set of other frameworks (CDP, Transition Pathways Initiative, SASB) to disclose climate risks in the way that best suits their business.

2. **Forward-thinking companies are using climate risks for better strategic decision-making.** While shareholder interest may not be driving greater climate risk analyses within these companies, it does appear to incentivize greater disclosure even as shareholders struggle to define exactly what information they seek.

3. **The financial impact of climate risk has lagged in disclosures.** Companies remain circumspect on one or more aspects of climate risk disclosure – frequently on the details and financial implications identified in scenario analyses. This caution stems from a variety of causes including potential commercially sensitive information, a perception that the outcomes of scenario analyses are speculative or because the company is keen to work with regulators around outcomes before they are publicly disclosed.

4. **Legal liability associated with climate risk disclosure continues to represent a challenge, particularly in the United States.** Interviews suggest that it will be important for the U.S. Securities Exchange Commission (SEC) to address questions of fiduciary duty with regard to the financial materiality of climate risk.

5. **There is a call to action for investors and regulators.** Regulators, particularly in the United States, must reduce the potential liabilities associated with disclosure of climate risks by clarifying the financial materiality of climate change. Investors need to coalesce around an expected threshold of practice. How much disclosure, and in what form, will be considered sufficient and decision-useful?

The recent events of the COVID-19 pandemic may well serve as a trigger to re-accelerate disclosure amongst leading companies. There are signs that corporate sustainability could play a larger role for businesses seeking to emerge and grow in the post-COVID economy. Business resilience planning could enter a new age where global risks become mainstream concerns for corporate financial planning. Governments providing massive stimulus payouts may focus on priorities such as clean energy and green infrastructure as the means to spur economic growth. If these scenarios come to pass, we expect that climate risk disclosure will accelerate again across the board.

Introduction

Headlines from major asset managers including the latest letter from Blackrock's Larry Fink to corporate CEOs highlight the importance of climate change risk and opportunities to mainstream investment strategies[7]. In the letter, Mr. Fink points to climate change as a driver for a "fundamental re-shaping of finance" that is "compelling investors to reassess core assumptions".

The Investor-Company Gap on Climate Risk Disclosure

Investors have increasingly looked to environmental, social and governance (ESG) aspects of corporate performance to better understand the potential risks and opportunities that they present to profitability[1]. Particular interest has been paid to climate change: risks and opportunities from emerging low-carbon energy, more severe weather patterns, government commitments to emission reduction and evolving consumer preferences.

We have seen markers of rapid change from companies as well. BP announced in February 2020 that it has set a new ambition to become a net zero company by 2050 or sooner[2]. Equinor, previously the Norwegian Oil and Gas company Statoil, has undertaken a significant shift toward renewable energy over the last several years[3]. Hundreds of companies have set targets to reduce or eliminate carbon emissions in line with the 2015 Paris Climate Accord goals of limiting global warming to 1.5 degrees[4].

"Aiming for net zero is not only the right thing for BP, it is the right thing for our shareholders and for society more broadly. As we embark on this ambitious agenda, we will maintain a strong focus on safe, reliable and efficient operations and on delivering the promises we have made to our investors."
Helge Lund,
BP Chairman

While the nature of the risks to companies from climate change are well-defined, and the empirical data has demonstrated a clear link between climate leadership and financial returns[5], the disclosure of the specific financial implications of climate change on corporate performance have lagged. In response to the growing interests of shareholders as well as the difficulty in obtaining comparable information on climate risk, a number of investors supported a set of Guidelines developed by the Taskforce on Climate-related Financial Disclosure (TCFD) in 2017[6]. The TCFD Guidelines are intended to provide a consistent format of risk assessment to support not only disclosure to investors, but also to allow consistent management of these risks and opportunities for the company itself.

Previous research by ERM and the Yale Center for Business and the Environment (CBEY), *Investors Push the Pace of Climate Risk Financial Disclosures* (May 2018), reported that almost 90% of investors surveyed indicated that climate risk information belongs in the mainstream financial report either in the risk section (53%) or the audited financial statements (35%). The implication of this expectation is that enterprise-level risk assessment and ESG "materiality processes" need to be reconciled in order to better understand the financial materiality of climate change risk to a company. This also implies that investors expect higher standards of data quality and methodological rigor for climate change risk information to allow auditors to sign off on the validity of the data.

In parallel with these higher expectations for information and data quality, the research found that investors expected greater disclosure of climate change risks and opportunities on the timeframe of 1-3 years. The survey, conducted in 2018, showed that a third of investors sought information in the 2018 financial year disclosures while an additional 47% expected information within a three year horizon.

What remained unclear from this previous research was the nature of the disclosure expectations from investors. For example, while the TCFD has been widely supported by investors as a tool toward greater disclosure, it should be considered as an average expectation amongst investors rather than a consensus.

That is, some investors are pushing for very high levels of data quality, strategic information, scenario analysis detail, etc., while others are seeking a more constrained set of metrics on climate risks and opportunities that can promote comparability between companies in a portfolio. This lack of consensus amongst investors on what is decision-useful climate change risk information means that the expectations communicated to companies can be inconsistent and evolving, even as it is urgent. The result for companies is that, while there is general support amongst investors for climate change risk information, the nature and extent of that information, and how it is disclosed, has been left largely up to the companies themselves and some are hesitant to move forward quickly in view of other perceived barriers.

Testing the Pace of Change

In light of this dynamic – disparate and evolving investor expectations combined with significant urgency – it is difficult to assess the pace of change in climate risk disclosure by looking at investor data. In order to understand the pace of change, we need to look at how companies are responding to this broad push for greater disclosure.

To date, disclosure from companies ranges from no action to stand-alone climate reports to associated risk information integrated into audited financial reports. However, there is very little information that looks across companies and sectors to assess the pace of climate risk disclosure, uptake of scenario analyses and/or TCFD implementation. As a result, we recognized a clear need to map the pace and extent of climate change risk disclosure and TCFD implementation by companies.

This research is designed to understand fundamental questions of company disclosure on climate risks and opportunities:

1. How quickly are company disclosures on climate risk and opportunities evolving?
2. What is the “arc” of implementation? Is implementation speeding up or slowing down? Does it appear that company disclosures will plateau before fully meeting the TCFD recommendations?
3. What aspects of climate change risk disclosure are moving most quickly/slowly and what are the hurdles to those aspects that are moving more slowly?
4. Is investor pressure forcing greater disclosure by companies, or are companies pursuing greater disclosure as a strategic benefit supported by investor pressure?
5. Are there particular trends in disclosure amongst key sectors and what do the next several years look like for climate risk and opportunity disclosure?

The full research methodology is detailed in the Appendix.

Evolution of Corporate Climate Risk Disclosure

There has been rapid movement toward greater disclosure of climate-risk information by companies

There is a clear trend in the Oil and Gas, Energy Utilities, and Food and Agriculture sectors towards greater disclosure of climate-related risks. The observed disclosure is primarily focused on the nature of the risks, the implications of these risks on the company, and the governance structures that that company has in place to address these risks. There is significantly less discussion of opportunities to businesses stemming from climate change. There also appears to be less commitment to publicly disclosing the results of detailed scenario analyses within the studied sectors as well as less commitment to calculating potential dollar value of the identified risks.

This overall result agrees with recent findings from Datamaran (an ERM business partner that specializes in identifying and monitoring external risks for ESG purposes through an AI-powered data platform) that tracked the frequency and context of climate change discussion in corporate disclosures. The Datamaran survey observed a similar increase in the mention of climate change among Financial Services companies and an associated increase in the number of climate change-related regulations and voluntary initiatives[8].

Within each sector, there are groups of companies that have made “jumps” in disclosure over the last three years. For example, in the Integrated Oil and Gas sector, 13 of the 18 companies showed a significant increase in score over the observed time period (Figure 1). Many of these “jumps” correspond to shareholder resolutions. Over the three years tested, 14 of the oil and gas companies received shareholder resolutions associated with climate risk including all 13 of the companies that demonstrated a significant increase in score.

We were interested to understand how the disclosures of companies compared with the expectations of shareholders. We therefore scored several shareholder resolutions using the same scale and found that an average shareholder resolution would compel a disclosure score of 13.5 using our methodology. If a company received resolutions of all types (disclosure, scenario analysis, target-setting), the resulting score would average 33 points on our scale.

By and large, the observed “jumps” have met the 13.5 point threshold defined by the average shareholder resolution. We also note that many of the globally-integrated oil and gas companies exceed the maximum shareholder resolution score threshold of 37 points based on our assessment. The results suggest that companies faced with resolutions have responded convincingly and that leading companies are staying well ahead of these investor resolutions.

Independent, upstream oil and gas companies headquartered in the US are also moving forward in climate risk disclosure, although the extent of that disclosure appears to lag the integrated companies (Figure 2). The smaller, independent upstream companies show significantly lower average disclosure scores compared to large-cap companies. While it is tempting to ascribe the difference between these sections of the Oil and Gas sector to shareholder resolutions, the data suggest other factors are in play as well. First, each of the two sub-sectors received a similar number of shareholder resolutions over the time period studied. Our interviews also suggest that upstream oil and gas companies perceive less exposure to climate-risks due to the nature of their operations, and also that that they face less pressure from stakeholders outside of shareholders. There may also be lower levels of slack funds to invest in greater scenario analysis and disclosure for smaller-cap companies.

We also observed “jumps” in the Energy Utility sector analysis (Figure 3), although not as frequently as oil and gas. The Food and Agriculture sector has the fewest number of “jumps” (Figure 4). The results suggest that large integrated oil and gas companies may be the tip of the spear in climate-risk disclosure followed by Energy Utilities. Food and Agriculture as well as mid-cap upstream oil and gas companies appear to be lagging behind these other sectors.

Regionality, and associated presence or lack of regulation, also likely influences the level of disclosure. Of those companies in all sectors that show disclosure scores of 10 or less in all three years, approximately 66% lie outside the United States and Europe – primarily in Asia. This mirrors other historic sustainability trends such as adoption of the Global Reporting Initiative Reporting Guidelines where European companies led the way, followed by North America and then the rest of the world[9].

"When the TCFD was released, we were already reporting on climate risks to the company, but they were not easy to find on the website. So it was difficult for investors to discern the story. TCFD was a useful leverage point for us to pull information together into one place. This, in turn, has been useful for us to look internally at processes to make sure they are all tied together and working in the same direction."

"For over a decade we have been employing scenario resource planning process. This process is updated internally and externally annually and serves as a basis for all of our resource decisions. Out of that we construct internal carbon prices and assess resilience, grid modernization, etc."

Drivers and Barriers

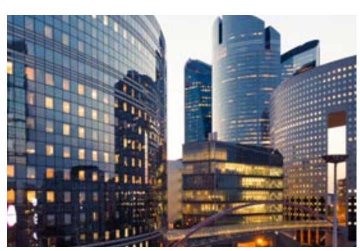
We used the interviews with companies to explore the drivers and barriers to climate risk and opportunity disclosure. One of the prevailing themes of these interviews is that, in the absence of a cohesive message from shareholders or other stakeholder groups (such as regulators) on what climate risk disclosure should look like, companies are looking internally to the value of climate risk analysis to shape their disclosure strategy. In particular, leading companies indicate that internal strategic decision-making is a key value to climate risk analysis – for example, asset planning, supply chain risk assessment and product portfolio planning as well as the governance structures to support these decision-making processes.

Internal value as the predominant driver for disclosure has implications for what is disclosed. First, companies indicate that while the TCFD has been useful for framing the disclosure (for example constructing reports that echo the four pillars of the TCFD), the selection of metrics to measure climate risk is mostly a function of business priorities rather than seeking comparability with peers to aid in investor decision-making. This trend should concern corporate executives and board members. Recent research from McKinsey demonstrates that investors are currently unable to use sustainability disclosures, such as voluntary sustainability reports, to inform investment decisions. Therefore, the burden of disclosure for the financially material issue of climate risk will continue to fall to disclosures against the TCFD or similar frameworks[10].

The second implication of the internal value driver is that companies are keen to disclose on areas of risk where the controls are well established or where the company has a greater degree of influence on the outcomes. So, for example, company disclosure tends to highlight resilience and adaptation efforts to severe weather over economy-wide implications from trends in energy demand.

The third, related implication is that companies are more cautious about the value of scenario analysis. This caution includes both the details of the scenario analysis methodology which can be heavy with assumptions, to the implications of scenario analyses which can be perceived as quite speculative. This caution has made disclosures of financial implications of scenario analysis fairly rare amongst the studied companies. A previous survey by ERM of 120 Chief Financial Officers and Chief Sustainability Officers found that the finance function is largely lagging in awareness and prioritization of climate risks suggesting that the gap between scenario analyses and financial implications is still prevalent.

Our interviews identified other barriers to disclosure within companies as well, including concerns around commercial sensitivity of the business strategies to address climate risks. Amongst highly regulated sectors, there is also caution to work in collaboration with regulators to disclose strategic planning elements rather than announcing them in isolation. Finally, legal liability associated with climate risk disclosure continues to represent a challenge, particularly in the United States. Our interviews suggest that it will be important for the U.S. Securities Exchange Commission (SEC) to address questions of fiduciary duty with regard to the financial materiality climate risk if the pace of disclosure is to accelerate[11].



Looking Forward

"There are a few areas where we will seek to increase information disclosure based on findings from our 2018 CDP reporting. So there is some continuous improvement to be undertaken. The value of this is for investors and external audiences. The internal value is fairly well understood and more or less completed."

The drivers for "full disclosure" against the TCFD guidelines do not appear to be in place today. Specifically, disclosure of detailed scenario analysis and projections of financial implications on companies from climate risks have less internal value for disclosing companies than disclosures of risk assessment outcomes, governance and control mechanisms and metrics for tracking risk. The result is that the current state of disclosure resembles voluntary sustainability reporting efforts where companies are "testing the water" with investors to see what level of disclosure is sufficient. Therefore, the largest remaining question is, "how quickly will company disclosures accelerate to treat climate risk as a fiduciary duty?".

It appears the push for disclosure of financial impacts of climate change, if it is to materialize, will have to come from investors and regulators and in reality, applied by auditors in statutory returns. The primary role of regulators will be to reduce the potential liabilities associated with disclosure of climate risks. In the absence of regulation calling for disclosure of scenario analysis and financial implications of climate risk, the potential, whether real or perceived, for liability from disclosure remains.

"About 70% of investor calls get into climate change disclosure. Frequently they are asking us to tell them what they need to know. Some see the TCFD as a convenient check-mark. In terms of using the information, we are in early stages, but investors don't seem to be using that level of information yet for investment decisions. Rather, investors are looking for progress in some form or other each year."

Investors will have two roles in moving the pace of disclosure. First, investors will need to coalesce around an expected threshold of practice. How much disclosure, and in what form, will be considered sufficient and decision-useful? The answer to that question is currently variable and evolving, but appears, based on resolutions, to fall short of the full TCFD recommendations. The second role for investors will be to clarify the value of financial impact assessments. There is currently little faith in the calculation of financial impacts from climate risk because they are based on uncertain scenarios and the methodologies for calculation of value at risk are still evolving. In the face of these uncertainties, it is not clear why companies would disclose unless investors detail the ways that they will use this information in their own investment strategies.

"Will be updating our climate report in line with our updated goals. We will not necessarily undertake an annual update and there is currently no appetite to put this information into our annual financial reports because it is speculative, the dollar figures are uncertain and investors are not yet asking for the information in that format. There seems to be recognition that information is qualitative and uncertain at this point."

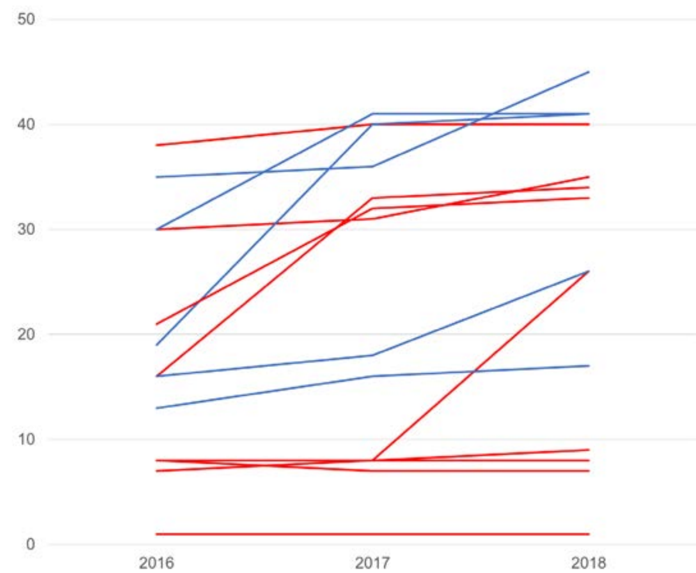
As investor and regulator action evolves and takes hold, it appears that the pace of change in climate risk disclosure will vary based on sector and current leadership. We expect that there will be some acceleration amongst mid-cap companies in the Oil and Gas as well as Energy Utilities sectors as well as for large companies in other sectors such as Food and Agriculture, fast moving consumer goods, heavy manufacturing and technology as they catch up to the current leaders.

"We see value in disclosure in order to meet the expectations of investors. But going beyond that to be in accordance with TCFD – it is currently unclear what the value might be."

While our analysis suggested that leaders in energy and Oil and Gas might slow down in climate risk disclosure, the recent events of the COVID-19 pandemic may well serve as a trigger to re-accelerate disclosure amongst these leaders. There are signs that corporate sustainability could play a larger role for businesses seeking to emerge and grow in the post-COVID economy. Business resilience planning could enter a new age where global risks with impacts akin to the pandemic such as climate change, chronic water shortages and loss of ecosystem services on a global scale become mainstream concerns for corporate financial planning. Governments, which suddenly have a heavier hand on the “tiller of the market” as a result of massive stimulus payouts may focus on priorities such as clean energy and green infrastructure as the means to spur economic growth. If these scenarios come to pass, we expect that climate risk disclosure will accelerate again across the board.

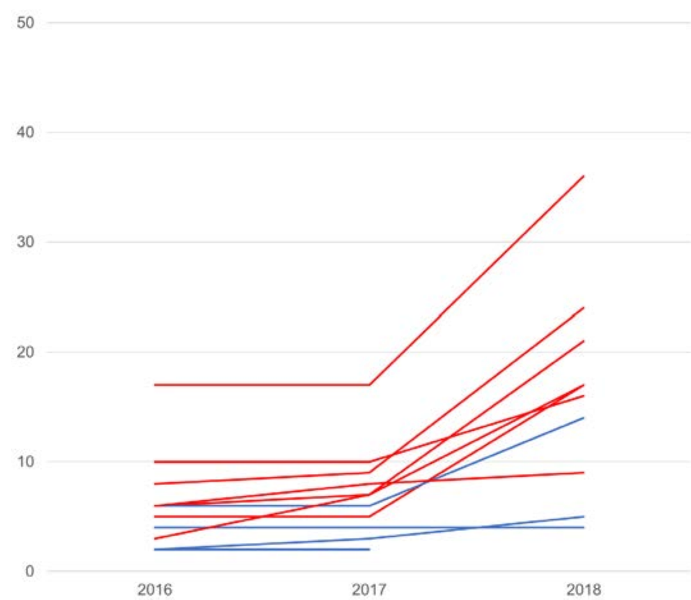
Figures

Figure 1: Global, Integrated Oil and Gas Company Disclosure Scores from 2016-2018



*Red lines represent companies that received a climate-risk related shareholder resolution within the studied time period

Figure 2: Independent, Upstream US Oil and Gas Company Disclosure Scores from 2016-2018



*Red lines represent companies that received a climate-risk related shareholder resolution within the studied time period

Figure 3: Global Large-Cap Energy Utility Company Disclosure Scores from 2016-2018

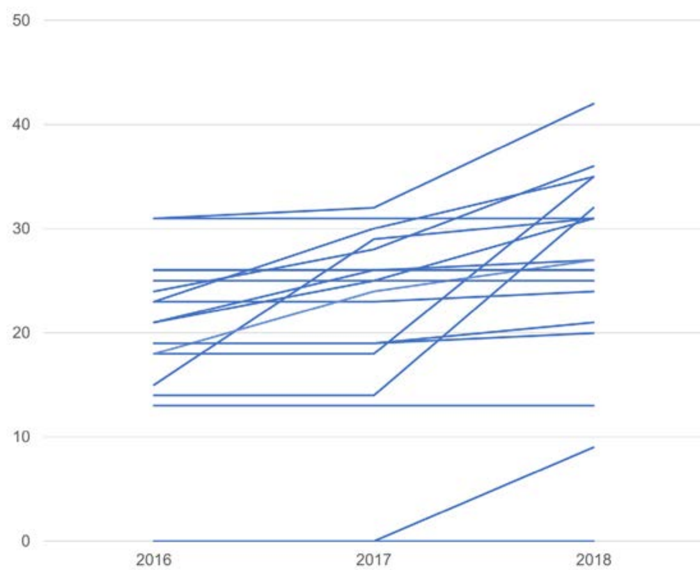
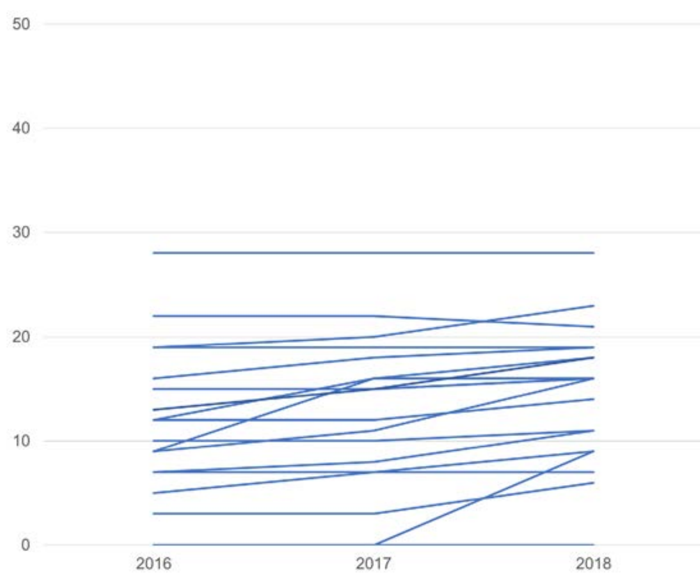


Figure 4: Global Large-Cap Food and Agriculture Company Disclosure Scores from 2016-2018



Appendix: Research Methodology

The first part of the research was to map the level of climate risk and opportunity disclosure on a consistent and comparable basis. To achieve this we created a scoring system in order to compare the climate-risk disclosures between companies. The scoring system assesses the extent of disclosure using the four pillars of analysis from the TCFD: Governance, Strategy, Risk Management and Metrics & Targets. We broke each Pillar down into four constituent elements. The Pillars and Elements are presented in Table 1. We then defined four Tiers of Practice for each of the Elements. The Tiers of Practice were constructed based on best practices defined and illustrated in the TCFD Implementation Guide produced by CDSB and SASB[12]. Each Tier was then assigned a point value from 0 to 3 making a maximum possible score of 12 for each Pillar and 48 overall.

Table 1: Pillars and Elements of the Scoring System

Pillars	Elements
Governance	Board Structures
	Board Processes
	Management Structures
	Board-Management Connection
Strategy	Business Strategy
	Financial Planning
	Scenario Analysis
	Integration
Risk Management	Risk Identification Process
	Risk Management Process
	Scope of Climate Risk Assessment
	Integration of Climate Risk Process
Metrics & Targets	Selected Metrics
	Business Alignment of Metrics
	Data Methodologies
	Targets

After constructing the Scoring Framework, we assessed the climate-risk disclosures from 2016, 2017 and 2018 for the largest publicly-traded companies by market capitalization within the following sectors:

- Global Oil and Gas:
    - Global Integrated Oil and Gas: 17 companies
    - Upstream US Independent Oil and Gas: 11 Companies
- Global Food and Agriculture: 20 Companies
- Global Energy Utilities: 20 Companies

The sectors were chosen as we perceive them to be the most exposed to potential climate risks and opportunities. We therefore hypothesized that we would see the most significant changes in climate-risk disclosure within these sectors.

In order to understand how company disclosures compare to investor expectations, we assessed four recent shareholder resolutions on climate-risk disclosure. These resolutions included requests for:

- Energy transition strategy
- Risk and scenario disclosure
- Governance structures for climate risk
- Metrics and targets for climate risk

We assigned a score for these shareholder resolutions using the Scoring Framework by assessing what Tier of Practice would satisfy the resolution. This provided an indicated threshold of expectation from shareholder resolutions. We found that the average shareholder resolution would be met by a score of 13.5 on the 48-point scale. If a company were to receive all four types of resolutions, we determined that a score of 37 out of 48 would meet the threshold.

In order to provide context for the scored disclosures, we conducted a series of interviews with eight companies as well in which we discussed the following questions.

- Where do companies see themselves on the performance defined by the Scoring System?
- Where do they anticipate going?
- Is climate risk reporting seen as a compliance effort that can be managed and then sidelined, or as an opportunity identifier that will serve as an input into business strategy assessments?
- What value do they see in moving “up” in their climate-risk disclosure?
- Where do their peers sit?
- Are companies increasing the assessment of climate risk and/or scenario analysis, but not publicly discussing these efforts?
- Are investors and those responsible for reporting in companies (investor relations, general counsel, sustainability professionals) content, frustrated or nervous about the pace and direction of change?

Notes from these interviews were compiled and used to interpret the results from the framework scoring.

Endnotes

1 Esty, D. and Cort, T. (2017) Corporate sustainability metrics: what investors need but don't get, Journal of Environmental Investing, (8) 1.

2 https://www.bp.com/en/global/corporate/news-and-insights/press-releases/bernard-looney-announces-new-ambition-for-bp.html

3 www.wsj.com/articles/getting-the-oil-out-norways-statoil-rebrands-1521110218

4 https://sciencebasedtargets.org/companies-taking-action/

5 Hundreds of empirical studies have established the link between corporate actions on climate risk and financial performance. Luke Templeton and Jim Reid of Deutsche Bank have provided a thorough summary of this link in their recent article "Climate Change and Corporates: Past the Tipping Point with Customers and Stockmarkets"; https://www.dbresearch.com/PROD/RPS_EN-PROD/PROD0000000000500285/Climate_change_and_corporates%3A_Past_the_tipping_po.pdf

6 www.tcfdhub.org

7 Mr. Fink's letter states that Blackrock would divest from companies that "present a high sustainability-related risk" (NYT, Jan 14; www.nytimes.com/2020/01/14/business/dealbook/larry-fink-blackrock-climate-change.html) . Similar statements have been issued over the last year by the leaders of State Street Global Advisors (www.statestreet.com/ideas/articles/ohanley-bloomberg-climate-change.html) and Vanguard (https://theboardinstitute.com/vanguard-ceo-open-governance-letter-companies/).

8 Datamaran (2019) TCFD: An Update on Corporate Disclosure Following the Second Status Report, www.datamaran.com/tcfd-update-corporate-disclosure/?utm_campaign=TCFD%20brief%202019&utm_source=mailmerge&utm_term=TCFD%202019&utm_content=TCFD%202019

9 KPMG and GRI (2016) Carrots & Sticks: Global Trends in Sustainability Reporting, Regulation and Policy, www.globalreporting.org/resourcelibrary/Carrots%20and%20Sticks-2016.pdf

10 www.mckinsey.com/business-functions/sustainability/our-insights/more-than-values-the-value-based-sustainability-reporting-that-investors-want

11 www.erm.com/news/erm-publishes-paper-on-climate-change-risk-the-new-investment-fundamental/

12 CDSB and SASB (2019) TCFD Implementation Guide: Using SASB Standards and the CDSB Framework to Enhance Climate-Related Financial Disclosures in Mainstream Reporting, https://library.sasb.org/tcfd-implementation-guide/

About The Yale Center for Business and the Environment

The Yale Center for Business and the Environment generates, incubates and launches business solutions to pressing environmental problems by 1) bringing theory to practice through innovative applied research projects and engaged learning across our global networks and 2) educating and training multi-disciplinary, global sustainability leaders. The Center joins the strengths of two world-renowned graduate schools—the Yale School of Management and the Yale School of Forestry & Environmental Studies—together with an extensive network of internal and external thought leaders at the nexus of business and the environment.

About ERM

ERM is a leading global provider of environmental, health, safety, risk, social consulting services and sustainability related services. We work with the world's leading organizations, delivering innovative solutions and helping them to understand and manage their sustainability challenges. To do this, we have more than 5,500 people in over 40 countries and territories working out of more than 160 offices.

For more information on this paper contact:

Todd Cort
Lecturer in Sustainability at Yale School of Management and Faculty Co-Director at Yale Center for Business and the Environment

E: todd.cort@yale.edu

Matt Haddon
Global Service Leader, Corporate Sustainability and Climate Change

E: matt.haddon@erm.com

James Stacey
Global Director of Climate Change and Low Carbon Economy Transition

E: james.stacey@erm.com

cbey.yale.edu
erm.com

ERM