LAUNCHING EVENT – REPORT FROM THE PROJECT TASK FORCE ON CLIMATE-RELATED REPORTING

How to improve climate-related reporting: A summary of good practices from Europe and beyond

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Good afternoon ladies and gentlemen,

It is a pleasure to be here today for the launch of the report on climate-related disclosures.

It is an additional attempt to spread advanced climate-related reporting practices made within an original set-up of the European reporting lab. It aims to foster transparency on climate change and its inevitable impacts on companies' business models and the damage companies' business causes to environment. This report is also a milestone in the journey toward meaningful disclosures when trying to address climate change, and is being issued somewhere between the June 2019 publishing by the European Commission of the supplement on reporting climate-related information and the expected revision of the NFRD later this year.

I want to take the opportunity of this event to warmly thank the European Lab Steering Group and European Lab team for their trust and support over the last 12 months. I of course express my gratitude to my two vice chairs, Jean-Francois Coppenolle and Bertrand Janus for their extensive efforts and engagement in delivering high quality work. Their involvement has been instrumental to producing incredibly valuable information. I finally want to thank all members of the Project Task Force for their contribution over the last year. The report is the result of collective efforts made in a spirit of transparency.

Some words about the task force:

Twenty-three persons selected into the Task Force by the Steering Group of the European Lab have worked together to identify good practices in climate related disclosures and climate scenario analysis. The combination of various backgrounds and nationalities has enabled Task Force members to benefit from completely different views on what good practice means. It is not the same for users and for preparers, for investors and for academics, for large companies or small sized ones. The Task Force has been fortunate to be able to rely on the plurality of its composition which has led to fruitful discussions. The other side of the coin is that it has sometimes been tough to reach a common understanding or align our views on what should be highlighted as good practice and on how to improve existing disclosures. Our debates have sometimes been sharp, but the end result has benefitted from the plurality of members' views.

I am lucky to work at SCOR, a reinsurance company. As such, we have internal experts on climate risks who for years have brought awareness at the top level of my organisation. As investors, we bear climate risks on our assets, while our liabilities are subject to climate risk mainly through our offering of protection against natural catastrophes. I am always amazed by the level of expertise of climate modelers. We are both preparers and users of climate-reporting information, and are exposed to physical and transition risks. Leveraging internal expertise has been key to bringing awareness to all lines of business. I often wonder if and how companies with no internal expertise are able to bring awareness, navigate through the necessary information to make up their mind and draw an adequate response to such a huge topic.

I won't take too much time to talk about the inevitability of climate change. A lot has already been said and there is still a lot to discover.

I think it is now time to "walk the talk" and transparency is obviously one way of fostering action.

Let's be clear, you can only report on what you are doing. For some preparers, regulation and mandatory disclosures have been the catalyst for defining what can be disclosed. For other preparers, it has been only a matter of fine-tuning what they were already doing to be able to disclose it on a consistent manner. In any case, transparency leads to a virtuous cycle in the sense that it creates competition among preparers and forces companies to move faster to stay in the race. It is also beneficial for the so called "laggard" companies as they may be inspired by more advanced reporting companies to start or accelerate their own journey. However, as climate change risk is still emerging, it is quite tough to navigate through all the available information. Even when following the structure of the TCFD recommendations or the NFRD elements; reports are not equally balanced, information is not presented the same way and the advanced reporting is to be found alongside less good reporting.

General considerations

In this exercise, the Task Force has done its best to extract good practices. It is an inevitably subjective exercise regardless of methodology applied to select good practices. To minimise the subjectivity, we spent time deciding on how to remain as neutral as possible when selecting examples out of roughly 150 reports that were from mainly European companies. From these examples, we have highlighted good ways of reporting that could be easily replicable by companies from different sectors and of different sizes.

We also contrasted preparers' and users' perspectives on the examples and reporting practices as they do not always share the same view on what should be disclosed. This being said, the following questions could arise: should we advocate for full standardisation of climate reporting? How far should standard setters go in setting mandatory information?

I personally do believe we should go for a right balance between standardised information to ensure comparability of reported information while leaving some leeway for company specific information. Before making an investment decision, investors need to understand a company's business model and risks as well as the measures taken to mitigate these risks and also seize the opportunities offered by the climate transition. The need for comparable information only comes after a company is eligible to be included in the investment universe. But this is my own view and the mandate of the Task Force was clear: it was not on setting standards or proposing a new framework or guidance for reporting. It was neither to judge the climate strategy of companies nor to assess the adequacy of their initiatives to tackle climate risk. It was not about who is doing better in climate risk mitigation and adaptation but about who is reporting better.

We have focused on companies' reporting practices, that is to say the way they are reporting: format of the reporting, clarity and usability of the information, articulation between pieces of information. Also, when trying to show how to improve the current state of play, we have mentioned pieces of information that were missing to better understand the current message and not to improve the company's strategy vis-a-vis climate risks.

So, what have we found?

Needless to say, as a general conclusion of the Task force members and also in numerous reports and studies on climate related reporting, is that there is room for improvements despite the significant efforts of companies to better address the topic and the progress made over the last reporting cycle. The "outside-in" effect of climate change is more advanced, but the revised Non-Binding Guidelines have only been published last June and thus could not be found in this reporting cycle.

The level of maturity is highly unequal between companies across and within different sectors. It is however a positive finding that most advanced reports are produced by companies operating in sectors highly exposed to climate risk (mainly transition risk). This raises a question of whether this finding is the consequence of a materiality analysis or the fact that a shock on carbon pricing may be easier to understand and to deal with?

Beyond energy, utilities and basic material, some companies in the financial sector are also showing some advanced practices. As investors, they are on the radar screen of regulators and soft and hard law has already pushed them to be more transparent and to take steps to finance the transition to a green economy.

There is a huge gap between what preparers and what users expect. Companies are at early stages of non-financial reporting and information disclosed is often vague and mainly qualitative. Sometimes the reporting looks more like a compliance or a communication exercise, providing very little comfort on how the company tackles climate change at top management level. Yet, users are often asking for quantification to ensure comparability, and they expect clear and organised information which has been subject to the right level of assurance.

Some companies have shown leadership in reporting on climate. But it is hard to find any that has reached a level that fully addresses the topic in a consistent way. More interestingly, good reporting practices have been found outside of this leading group of companies. And even amongst the most advanced, “connecting the dots” and providing a well-articulated report seems to be a challenge. As an example, it is always tough to make the link between strategy, how it results from a materiality analysis and to what extent metrics demonstrate that the strategy is on track. Again, reporting performance against targets is the only way to provide transparency on emission reduction but this part is often missing.

Information is often too generic, that is to say that it could be applied to any company (of the same size, or of the same sector) missing the objective to explain how the company embeds climate change in it’s own business model and which risk management processes and results have led to potential adjustments in its strategy. Either the materiality analysis concludes that the exposure is not material with no required change in the strategy or that it is material but there is no clear strategic response.

When reviewing climate-related disclosures and having in mind either the TCFD recommendations or the NFRD requirements; metrics and targets look more mature than governance, strategy / business model and outcomes or risk & risk management. This raises some concerns about how a company defines metrics and sets targets with inadequate governance and limited awareness on the topic. Remember, reporting is not a compliance exercise. It should be considered at the highest level by those charged with the governance of companies and it should deliver meaningful information to users.

Despite these key limitations of current climate reporting practices, which is still largely in its infancy and is subject to considerable year on year improvements, most companies are making steps in the right direction which is encouraging. Faster and better improvements are now needed.

Focus on scenario analysis

Climate scenario analysis is in some way the backbone TCFD reporting as it allows companies to assess the viability of their business model under different climate change outcomes, from the most moderate to the most severe. Climate scenario analysis is also, by far, the most technically challenging aspect of climate reporting. The Task Force therefore decided to perform a specific analysis of how companies deal with scenario analysis. At first glance, it appears as the least advanced section of climate reports. But let me repeat it, it is also the most complex and the most business sensitive one. Transition scenario analysis looks more advanced than physical risk scenario analysis. This is likely because most advanced companies operate in carbon intensive sectors for which climate change is a proximate and acute risk. Transitioning to a low carbon economy will with no doubt impact those companies.

Physical risk is more widespread and may materialise in a longer time horizon, in any case out of the time horizon of companies' business plan. The "tragedy of the horizon" is still well alive even if practices start to move as evidenced in some reports reviewed by the Task Force. Too many uncertainties surrounding both climate pathways and political responses are often used as an explanation for not being able to either develop relevant scenario analyses or to be able to translate the results into business decisions. Tables mentioning clear assumptions, lines of business, time horizons, strategic analysis and answers have been stressed as a user-friendly way of disclosing on scenarios.

As a conclusion,

A gap remains between TCFD recommendations and NFRD requirements and the current state of play of climate-related disclosures. Nevertheless, we have been able to spot some cutting-edge practices that can pave the way for more mature reporting in the future, and I hope you will enjoy discovering them in the two supplement documents to the main report that include snapshots and analysis of examples of companies good reporting practices.

Visual information looks easier to understand than long narratives that often fail to "connect the dots". Preparers should not undermine nor overcomplicate the topic but provide a clear and transparent reporting backbone. This could be facilitated by the development of standard for non-financial reporting and I welcome the remark of EVP Dombrovskis on this matter last week.

My deepest wish is that this report becomes obsolete by the end of the next reporting cycle. That would be the best evidence of climate-reporting transparency having really moved forward!