Local Authority Pension Fund Forum

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The Climate Disclosure Standards Board (CDSB) Reporting Framework

Invitation to comment
September 2009

Response by the
Local Authority Pension Fund Forum, LAPFF

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Background

The Local Authority Pension Fund Forum, LAPFF was set up in 1991, as a voluntary association of local authority pension funds based in the UK. LAPFF exists 'to promote the long term investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance amongst the companies in which they invest.' The Forum currently consists of 49 members who currently have combined assets of over £80 billion.

The Forum has taken the opportunity below to provide our view on those issues which we consider relevant to our activities.

Response to Questions

1. ***Do you agree that a single global framework for climate change-related disclosure in mainstream reports is necessary and/or possible, notwithstanding the background of different national developments? If not, please explain why.***

LAPFF believes that a single reporting framework is essential in the context of initiatives seeking a consensus on global action required to tackle climate change. As international climate negotiations progress, it is essential that there is a globally accepted disclosure framework in place as soon as possible, so as not to impede the urgent progress that these negotiations need to make.

The Forum is co-signatory to the 2009 'Investor Statement on the Urgent Need For a Global Agreement on Climate Change', signed by investors collectively managing more than more than $13 trillion in assets. This sets out how a long-term global target for greenhouse gas emission reductions is essential to give investors confidence in the future direction of climate policy, and this should be for global greenhouse gas emissions to decline by 50–85% by 2050. Such reduction targets will only be credible if supported by a globally accepted framework for measuring emissions, which the Forum views not only as possible but also necessary.

For investors, a single reporting framework would be useful as part of a comparison of company practice across sectors and geographic regions. However, LAPFF does not think that this single framework should have the same implications for different companies. Companies in different sectors may comply with the framework with varying degrees of detail.

Legal frameworks in different national contexts may hinder the process somewhat. Through LAPFF's engagement with some UK-listed companies in the oil and gas sector, concerns have been raised that companies are not legally allowed to report GHG emissions for some of the counties they operate in since

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by doing so they stand to lose their licence. It is not the Forum's role to judge the legitimacy of such claims but as they could be material, the Forum believes that they are worth noting. Reporting all emissions at an aggregate level is one way for companies to get around this problem.

2. ***Do you agree with CDSB's overall approach of aligning its Guiding Principles to existing relevant principles and objectives of financial reporting so as to elicit information of value primarily for investors? If not, please explain why and share with us your ideas for a new/different approach to climate change-related reporting*.**

LAPFF agrees with the principles-based reporting framework as it does not dictate exact reporting rules but highlights areas to consider. This makes the framework broad enough to give flexibility in reporting sector-specific issues. The Forum further recognises that the Framework is 'the nexus around which guidance and principles can be developed over time'.

While it is important that forming a single reporting system should not conflict with existing reporting systems, this broad view may have come at the cost of focussed direction. The principles approach, although not prescriptive does not currently provide enough specific direction, especially at sector-level, so the Forum welcomes the CDSB's plans for further development in this area.

3. ***At the current stage in its development, the CDSB Reporting Framework, including the Reporting Templates, are designed for general use by all companies within the stated scope of applicability. Do you agree that further work is required to develop the Reporting Framework, including the Reporting Templates, to take account of particular sector-specific issues related to climate change? If so, please provide your recommendations, referring to particular sector specific climate change-related initiatives if possible.***

The Forum believes that a sector-based approach to climate change disclosure is important as company comparisons are usually made within a sector rather than between sectors.

That said, the reporting templates need not change significantly but rather could include a description of what is expected of each sector. These expectations are implied in the draft through the concepts of 'materiality' and 'relevance', but further guidance could be provided here to give some direction as to which types of companies need only complete minimum disclosure requirements and which should go beyond these. This guidance will ensure:

a) that high-emission sectors <u>go beyond minimum disclosure requirements</u>

b) that companies in sectors with low emissions use their time and resources efficiently by reporting information in Template 4 that is material as defined by the minimum disclosure requirements.

Such guidance could state what is expected of each type of company by categorising it according to:

a) their sector or
b) their particular emissions level or
c) their market cap.

4. Do you agree with the principles and characteristics of decision-useful information that CDSB recommends for making judgments on the information to be disclosed under CDSB's Reporting Framework? If not, what additional principles or characteristics are required, or which ones suggested in the Framework would you change?

LAPFF does not make investment decisions on behalf of its members and therefore the concept of decision-useful information as outlined in the document would not 'influence a decision on whether to invest or continue to invest in a company'. However, company reporting that fulfils the characteristics of decision-useful information is useful in formulating company and sector engagement strategies. LAPFF engages with companies on a range of environmental, social and governance issues on behalf of its members and company disclosure plays a large role in steering the initial stages of this engagement.

The Forum pays particular attention to disclosure of emission reduction targets as well as the number of years of performance data available. Here it is useful if the decision-useful information as identified in Template 4 shows at least two years data, but up to five years where-ever possible.

In terms of applying the guiding principles on decision-useful information, another constraining factor could include 'business competitiveness'. In LAPFF's engagement with some companies regarding their approach to disclosure on climate change performance indicators, this has been raised as a particular reason for not reporting emissions. This is a concern because for the company this may highlight the costs of production and therefore related profit margins with competitors.

5. Do you agree that the CDSB characteristics of decision-useful information are practical for companies to apply and sufficient to limit the amount of information disclosed to the most relevant content for users? If not, what additional guidance or information do you suggest CDSB include?

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The Forum considers the characteristics are generally practical to apply, as well as sufficient to limit information to that which is relevant for companies in different sectors.

As a general rule, the Forum considers emission-related disclosure to be most useful for companies in high-emissions sectors, when considering Scope 1 and 2 emissions. It is in these companies where the decision-useful characteristics are both more practical to apply and can be limited to relevant information.

Strategic focus

How companies factor the relevance of climate change into their business strategy is a key part of the Forum's analysis when engaging with companies. The concept of 'comply-or-explain' could be useful to include as part of the disclosure framework. There are many companies in a variety of sectors who do not yet publicly demonstrate that they include a consideration of factors relating to climate change in their business strategy. It would be useful for companies to explain why they do not see it as such, as identified in Template 1. This approach may also help to get round the problem of having different expectations for each sector as it allows for companies who do not include any consideration of climate change in their forward-looking reporting to state this and to explain why.

Performance measures

For the Forum, emissions disclosure is most useful for companies who are in high-impact sectors. For these companies, reporting against performance indicators should not be a practical concern.

In particular, the Forum considers the statement about information enhancing *'the quality of decision-making when it communicates details about the link between climate change performance and financial performance using specific quantified measurements that can be used to demonstrate and track progress/efficiency'*[1] as an important element in the ongoing success of companies adopting the reporting framework.

However, the Forum considers that the guidance should address the care needed in linking the two. While climate-related performance may have an impact on financial performance, this is also driven by a wide range of other factors. For some companies it may be difficult to separate the specific financial impact of operational or strategic choices made relating to climate change.

Content

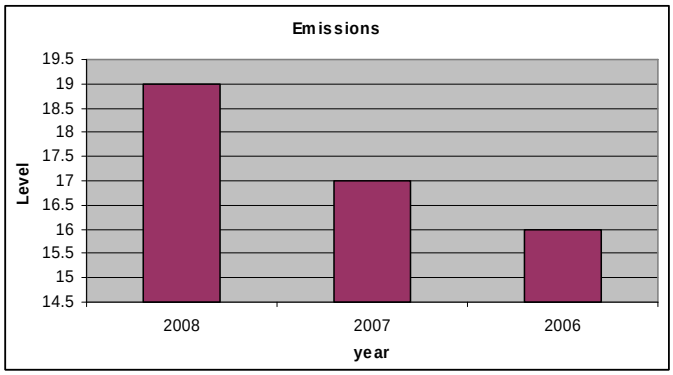
6. Do you agree with the content that CDSB recommends for potential inclusion in disclosures under the CDSB Reporting Framework? If not,

[1] p 19 of the Exposure draft

what additional areas would you recommend or which types of information in the Reporting Templates would you change?

The Forum considers that the information contained in the Reporting templates is relevant. The Forum would recommend that reporting Template 4 should include reporting of previous years' emissions alongside the current year. On a very specific note, it is common for companies to report emissions as in Figure A below which shows the years going from most current to further back along the x-axis. This is very misleading as it gives an impression of emission reductions. Guidance might therefore be given on how graphics should best be used to illustrate any numerical information.

Figure A



The example of Typico plc is useful in demonstrating proposed actual practice in reporting and that it is not necessary for all the information in the Reporting Templates to be included '*in the management commentary section of the mainstream financial report*'[2] such as the inclusion of 'all assumptions made in the preparation of the results' or 'the quantification methodology for calculating GHG emissions'. This could be made clearer in the guidance itself.

8. CDSB's proposed Reporting Framework requires companies to define and explain the performance measures and indicators they use to track and demonstrate their progress in responding to climate change. CDSB considers performance measures and indicators to be crucial elements of decision-useful information as they aid understanding and comparability over time, provided that consistent metrics are used year on year. Do you foresee particular challenges in setting and explaining performance measures and indicators, and using those metric on a consistent basis over time? If so, please explain those challenges.

The Forum recognises the challenges that exist in keeping year on year data comparable with changes in the size of the company (mergers/acquisitions) and

[2] p18 of the Exposure draft

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changes in production levels. Reporting emission intensity indicators enables better comparison of year on year absolute emissions if a company is growing or shrinking. As the guidance identifies, reporting both is essential, and the Forum particularly welcomes the 'compliance' emphasis on this part of the guidance.

The guidance on boundaries for reporting indicates that a financial control approach should be taken. The Forum agrees that this approach is the best way to ensure comparability and consistency.

The Forum does however note that in discussion with some companies, they indicated that in reality they can be reluctant to report in such a way. Instead they find it more practical to report emissions for projects where they have operational control. They also state that this ties in with emission-reduction targets which are based on areas where companies have operational control and, as such, reporting should be in line with these targets. On this issue, the Forum believes that reporting on a financial control basis should be the standard. Those companies who wish to include operational-control reporting may do so but only in addition to financial-control reporting.

Practicalities

11. Is there anything else of relevance you would like to raise?

'The characteristics of decision-useful disclosures described in this section are designed to assist preparers of mainstream financial reports to decide what to include, thereby making climate change-related information useful to investors[3].'

While LAPFF agrees with this statement, during the reading of this draft, it was noted that the concept of decision-useful information appears to be described in terms of relevance for investors as well for the preparers of the report[4]. The notion that this concept is relevant for preparers touches on the inherent conflict of interest that exists in company reporting. This is not raised in this report and of which the Forum believes there should perhaps be some mention.

The role of a preparer is to provide relevant, complete and true information which, by its nature, is then decision-useful. In trying to put a slant on their report that makes it 'decision-useful' however, preparers have an incentive to produce information in a type and style that encourages investors to make the 'right decisions' (in the view of the company).

The increasing problem of 'green washing' in the way that information is prepared is not touched on as it is perhaps beyond the scope of the paper.

[3] p18 of the Exposure Draft
[4] p 8 of the Exposure Draft

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However, the Forum believes that its presence as well as this conflict of interests should be noted.

In overcoming the ‘green wash’ problem, reporting that covers ‘the group of entities’ is particularly important not just for data reporting but for narrative commentary. When companies provide case-specific examples of community or environmental projects, these are not decision-useful for investors since they do not cover the group of entities. Such examples, while potentially interesting, also have the potential to add to green wash and mislead readers.

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