CDSB Climate Disclosure Standards Board

Climate and TCFD disclosure briefing: The state of EU environmental disclosure in 2020

In our new report 'The State of EU disclosure in 2020'[1] the Climate Disclosure Standards Board (CDSB) has taken a deep dive into the environmental disclosures of the largest listed companies in the EU. The third in the series, we pick up where our previous report 'Falling Short?'[2] left off, comparing where we were then, and what progress has been made.

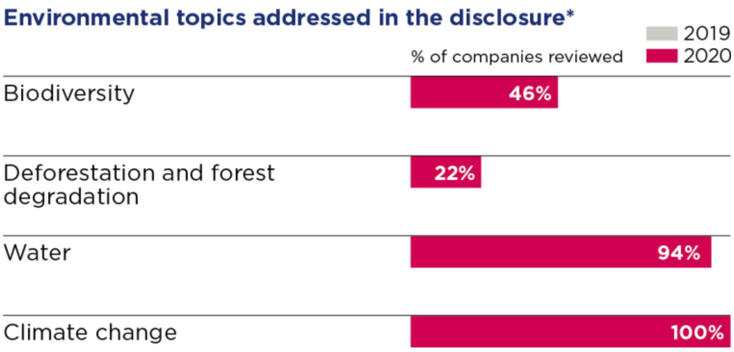
Supported by the LIFE programme of the European Union, CDSB reviewed the 2020 environmental disclosures of 50 of Europe's largest listed companies, with a combined market capitalisation of US$3.5 trillion, under the EU Non-Financial Reporting Directive (NFRD) and the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). Our analysis assesses the effectiveness of environmental disclosures in meeting the NFRD's purpose of increasing the relevance, consistency and comparability of company reporting to support informed stakeholder decision-making on sustainable development. It also supports the corporate reporting process by identifying good practice case studies and tips.

This briefing will provide an overview of the findings of the review with respect to TCFD and climate-related disclosures and provides recommendations for companies, policymakers and regulators. It complements two further topic briefings on water-related[3] and on biodiversity and deforestation and forest degradation-related disclosure[4].

Insights on TCFD and climate-related disclosure

Overall summary

Our research emphasised that climate change continued to be a core focus for corporate environmental disclosure in 2020, with all companies reviewed providing disclosure on the subject. This can be compared to relatively lower levels of disclosure on other environmental topics, as illustrated below.



*Aspect first assessed in 2020, therefore 2019 data unavailable

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[1] CDSB (2020) The state of EU environmental disclosure in 2020. [PDF]. Available from: https://www.cdsb.net/nfrd2020
[2] CDSB (2020) Falling Short? Why environmental and climate-related disclosures under the EU Non-Financial Reporting Directive must improve. [PDF]. Available from: https://www.cdsb.net/falling-short.
[3] CDSB (2021) Water-related disclosure briefing: The state of EU environmental disclosure in 2020. [PDF]. Available from: https://www.cdsb.net/nfrd2020
[4] CDSB (2021) Briefing on biodiversity, deforestation and forest degradation disclosure in the EU. [PDF]. Available from: https://www.cdsb.net/nfrd2020

Despite this emphasis on climate, our analysis still showed TCFD adoption to be inconsistent and incomplete. Whilst 68% of company disclosures now make some reference to TCFD, the vast majority have still only partially adopted the recommended disclosures.

Business model

Integration of climate change into the business model is increasingly prevalent, however the majority are still unable to provide a full and clear account as to how climate risks and opportunities inform their business strategy.

- 48% provided clear and specific disclosure on the climate-related aspects of their business model, e.g. providing information on their positive and negative climate impacts, and plans to manage these to ensure sustainable long-term value creation.
- 16% provided only more generic or high-level information on the climate-related aspects of their business model, e.g. stating an overall commitment to climate action, without providing sufficient clarity over the specific implications for the business;
- Although 64% therefore directly addressed the relationship between their business model and climate change as a particular topic of importance, this was less than the number that referred to environmental or sustainability issues in more general terms (94%); and
- 52% disclosed that they had, or planned to, use scenario analysis to understand their strategic resilience to different climate scenarios, however only 18% provided a clear conclusion as to whether they considered their business to be resilient to these scenarios.

Policies and due diligence

Well-articulated corporate policies provide the basis to inform and structure a company's environmental disclosure. Climate change was one of the key topics addressed in companies' environmental policies in CDSB's analysis, although specific disclosure on due diligence was not as widely disclosed.

- 98% of companies provided climate-specific commitments or goals within their policies, making it the most common environmental issue to be explicitly addressed;
- 86% of companies included a quantitative carbon emissions reduction target within their policy commitments; and
- 70% of companies disclosed both board and management-level responsibilities for climate change within their organisations, however 30% did not disclose both of these leadership accountabilities, as is recommended under the TCFD, providing only partial or more generic due diligence disclosure.

Outcomes

Reporting on policy outcomes enables investors to understand how companies are progressing against their commitments. All companies disclosed specific policy outcomes relating to climate change within their environmental statements.

- 86% disclosed their progress against quantitative greenhouse gas emissions reductions targets;
- 46% reported on their progress against science-based emissions reductions targets (aligned to a 2˚C or lower scenario), reflecting the fact that companies are increasingly aligning their climate policy commitments to the global policy agenda; and
- 16% included narrative commentary within their climate policy outcomes, which was not clearly linked to stated policy commitments or material issues, therefore contributing to lengthy disclosure.

Principal risks

Whilst consideration of climate risk is a key aspect of the TCFD recommendations, many companies continued to provide only generic or high-level disclosure on the risks that climate change posed for their business.

- 82% disclosed risks relating specifically to climate change, compared to 86% of companies to report on environmental risk more broadly, suggesting climate change is one of the most commonly considered environmental risk areas;
- 74% disclosed both physical and transition climate risks in line with the TCFD recommendations, an improvement on 54% in 2019;
- 88% integrated climate change into their wider risk management process, compared to 72% in 2019; and
- 96% did not clearly define their risk time horizons, or clarify how identified risks would impact the business over the short, medium and long-term as recommended by the TCFD.

Key performance indicators

Climate-related metrics were the most frequently disclosed environmental KPI type among European companies.

- All companies provided disclosure on their greenhouse gas (GHG) emissions, and an increased proportion disclosed information on Scope 3 emissions, relating to their wider value chain (74% vs. 54% in 2019);
- The quality of GHG disclosure also saw improvement, with only 6% providing disclosure which did not clearly identify emissions by reporting scope (i.e. Scope 1, 2 or 3), relative to 24% who did not provide this in 2019; and
- Climate-related financial metrics[5], as recommended under the TCFD Metrics and Targets core element and related to the disclosure required under the EU Taxonomy Regulation[6], were disclosed by only 36% of companies, showing little change since 2019 (32%).

Whilst climate change was a key focus in European companies' environmental disclosure in 2020, CDSB's analysis demonstrates that further improvement is needed to deliver decision-useful, TCFD-aligned climate information to investors. It is therefore imperative that companies and policymakers take action to improve disclosure, and provide the information needed to align investments to sustainable, low carbon, activities for the long-term.

Recommendations for corporate report preparers

1. Adopt the TCFD recommended disclosures in full, in particular integrating information into the mainstream report where it is deemed material

As evidenced in our review, TCFD implementation continues to lag with high-level commitments, with the majority now referencing the recommendations in their reports, but only a small minority providing disclosure

[5] Climate-related financial KPIs are indicators which link to the company's products and services or financial performance, e.g. turnover from climate-related products and services, low carbon capital expenditure or climate-related green bond ratios. Further detail can be found in the European Commission's climate-related guidelines available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52019XC0620(01).

[6] European Commission (2020) Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (Text with EEA relevance) [Online]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32020R0852

on scenario analysis and risk time horizons. CDSB has produced a wide range of resources to support companies in their journey to implement the TCFD recommendations, including:

- TCFD Good Practice Handbook, TCFD Implementation Guide (co-authored with SASB), and TCFD e-learning courses;
- The Building Blocks (co-authored with CDP), a paper highlighting how CDP data and the CDSB Framework can be used together to fulfil the TCFD recommendations;
- CDSB Framework application guidance for climate-related disclosures, which provides guidance on the integration of financially material climate-related information into the mainstream report; and
- Accounting for climate: Integrating climate-related matters into financial reporting, guidance focused on the adoption of climate-related financial disclosure within financial statements.

2. Communicate a clear roadmap for the iterative improvement of climate disclosure over time

It is acknowledged that full adoption of the TCFD recommendations is a process which will span multiple reporting cycles. Companies are encouraged to provide a clear roadmap for how they plan to address gaps in their disclosure over time. For example, a pilot scenario analysis disclosure may focus on certain business activities or regions, a single climate scenario, or limited climate risk types, but could be expanded upon in future disclosures to provide a more holistic view of strategic resilience. By providing transparency over their plans for improvement over times, companies can provide valuable transparency to their investors, enabling appropriate contextualisation of their initial TCFD disclosures.

3. Ensure risk disclosures include business-specific context on the nature of impacts and management

Whilst the majority disclosed climate change as a principal non-financial risk, often risk descriptions were too generic or high-level in nature to gain a clear picture of how climate change will specifically impact the business, and over what timeframes. In disclosing climate risks, companies should aim to provide sufficient context to enable the type of physical and transition risks identified, the expected business impacts (e.g. financial, strategic or operational) and the time horizons over which the risks may manifest to be clearly understood.

Recommendations for policymakers and regulators

1. Explicitly embed the TCFD recommendations into the Directive, as non-binding guidelines are not driving uptake at the necessary pace and scale to support investor decision-making

Whilst 68% of companies referenced or provided some disclosure aligned to TCFD in 2020 in their reports, adoption of the recommendations was found to be inconsistent and complete. The vast majority have still only partially adopted the recommended disclosures, with just 4% clearly defining risks over short, medium and long-term time horizons and 18% providing clear disclosure on their resilience to different climate scenarios.

Given the TCFD recommendations were integrated into the Directive's 2019 Guidelines on reporting climate-related information[7], it could have been expected that TCFD disclosures would have seen greater improvement in 2020 reports. The continued challenges in the quality and completeness of disclosures however indicates that voluntary adoption of the TCFD by Europe's largest companies, through its inclusion in non-binding guidelines, is not achieving the levels of disclosure required to fully inform investor decision-making.

[7] European Commission (2019) Communication from the Commission – Guidelines on non-financial reporting: Supplement on reporting climate-related information (C/2019/4490). [Online]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52019XC0620(01)

It is therefore evident that the TCFD recommendations must be embedded into the revision of the Directive itself.

2. Remove the exemption allowing the non-financial statement, and TCFD disclosure, to be reported outside the mainstream report, to support accessibility, consistency and comparability of disclosures

The European Commission has previously observed that "[i]t is hard for investors and other users to find non-financial information even when it is reported"[8]. This aligns with CDSB's findings, in that non-financial disclosures provided outside of the mainstream report were often fragmented in nature and not readily referenced from the mainstream report. Similarly, some companies have opted to produce standalone TCFD reports to address the recommendations, in addition to their existing disclosures, leading to increased complexity and duplication in disclosures.

In 2020, 82% of companies provided their NFRD environmental disclosure within the mainstream report, showing this continues to be the norm for most companies, with 84% doing so in 2019. Increasingly, those providing disclosure within the mainstream report, are also choosing to integrate the information within the relevant sections of the management report (61%, compared to 55% in 2019).

Requiring this as standard would better facilitate comparability of disclosures and foster stronger linkages across non-financial and financial disclosures. If the TCFD recommendations were embedded in the Directive as recommended, this would also ensure material climate risk disclosure is included within the mainstream report, as was intended by the TCFD. It is important to note that other forms of reporting outside the management report might be better suited for other stakeholders and more work needs to be done to address this.

3. Incentivise companies to do more to tackle climate issues, through ambitious policies and rigorous due diligence processes, by ensuring policy coherence between the NFRD review and the upcoming EU initiative on corporate governance

Whilst due diligence disclosures under the NFRD are expected to provide information on board and management level responsibilities of relevance from a corporate governance perspective, 30% of companies did not provide this information relating to environmental matters in their 2020 reports. Additionally, where governance information was provided, the level of detail and specificity it included on how environmental risks were managed, and in particular climate risk as requested under the TCFD recommendations, was often limited. The revision of the NFRD therefore presents a timely opportunity to ensure that companies disclose information on their internal processes and responsibilities over environmental issues, while the EU also takes legislative action to boost responsible business conduct through the upcoming initiative on sustainable corporate governance.

For any questions relating to this, please contact our Senior Manager, TCFD Technical Capacity Building Fiona Quinlan Fiona.Quinlan@cdsb.net.

[8] European Commission (2020) Inception impact assessment - Ares (2020)580716. [PDF]. Available from: https://ec.europa.eu/info/law/better-regulation/initiatives/ares2020-580716

Climate Disclosure Standards Board

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