CDSB Climate Disclosure Standards Board

Topic briefing:

TCFD disclosure under the EU Non-Financial Reporting Directive

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In May 2020 CDSB published its review of 2019 environmental and climate-related disclosures of Europe's 50 largest listed companies under the EU Non-Financial Reporting Directive (NFRD also referred to as 'the Directive').[1] Overall, we found that substantive improvements are still required in the quality, comparability and coherence of disclosures in order for the Directive to achieve its objective of providing investors and wider stakeholders with relevant, consistent and decision-useful disclosures.

As part of the review, CDSB considered progress made in implementing the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations [2] by Europe's largest companies. This topic briefing summarises the findings and recommendations of the review with respect to TCFD disclosure.

TCFD Disclosure under the EU Non-Financial Reporting Directive

In June 2019, the European Commission (EC) released its Guidelines on reporting climate-related information[3], which integrated the TCFD recommendations, providing guidance to companies to achieve disclosure that is consistent with both the NFRD and the TCFD. Whilst non-binding, the guidelines sent a clear signal to European companies that alignment of climate-related disclosures to the TCFD recommendations was expected. In the context of the EC's ongoing review of the NFRD, there is a further opportunity to strengthen and clarify mandatory reporting aligned to the TCFD under the Directive.

Background on the TCFD recommendations

Released in 2017, the TCFD recommendations set out 11 recommended disclosures, designed to solicit decision-useful, forward-looking information on the material financial impacts of climate-related risks and opportunities in mainstream financial filings. The disclosures were structured around four thematic areas representing the core elements of how organisations operate: governance, strategy, risk management, and metrics and targets.

The recommendations were designed to be adoptable by all organisations in the financial and non-financial sectors. Sector-specific supplemental guidance is also provided for financial (banks, insurers, asset managers, asset owners), energy, transportation, materials and buildings and agriculture, food and forest products sector companies.

The current state of play

By considering environmental and climate disclosure under both the NFRD content categories and the TCFD recommended disclosures, CDSB's review of 2019 disclosures provided the most up to date assessment of European climate risk disclosure. Overall, progress made in implementing the TCFD recommendations by

[1] 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
[2] TCFD (2017) Final Report: Recommendations of the Task Force on Climate-Related Financial Disclosures [PDF]. Available from: https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf
[3] 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)

T: +44 (0) 203 818 3939
www.cdsb.net

Climate Disclosure Standards Board
c/o CDP, WeWork Sony Center
Kemperplatz 1, 10785 Berlin
Germany

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Europe's largest companies was found to be lacking, with many sectors failing to address them effectively in their disclosures. Very few companies who provided some TCFD-aligned disclosure were able to provide full disclosure against all of the recommendations. Whilst some companies provided transparency over their plans to adopt the remainder of the recommended disclosures over future reporting cycles, often disclosures did not acknowledge or explain gaps in the adoption of the recommendations. The most progress was seen among companies in the energy and financial sectors. However, in other sectors progress was limited, with many companies not yet acknowledging the recommendations in their reporting.

Progress against the different TCFD themes

Governance

- 72% of companies reviewed disclosed board-level accountabilities and 76% disclosed management-level accountabilities regarding climate-related and environmental matters;
- 10% provided disclosures on their due diligence or governance arrangements, but did not state the roles and responsibilities of board or management; and
- Typically, companies did not explicitly separate climate-related accountabilities from those of other environmental matters, stating the committee or individual with oversight for the issues without sufficient detail on the specific arrangements or topics considered.

Strategy

- 90% of companies disclosed their principal environmental or climate-related risks, however only 54% demonstrated consideration of both physical and transition risks;
- While 82% disclosed at least one business impact associated with their reported risks, only 42% specifically addressed the impacts on their business model or strategy, and only 6% clearly described the impacts of the risks over the short, medium and long-term;
- 14% of companies disclosed their strategic resilience to different climate scenarios; and
- Others stated they had undertaken scenario analysis but did not provide quantitative disclosure of the outputs, or offer an overall view on their strategic resilience to the scenario(s) considered.

Risk Management

- 72% of companies disclosed that environmental and climate-related risks were integrated into the organisation's overall risk management. While 4% disclosed a separate process for identifying, assessing and managing environmental or climate-related risks, they did not specify how these risks were integrated into their wider risk management processes; and
- Due to the emphasis on risks in the NFRD, environmental and climate-related opportunities disclosures were not reviewed. CDSB's 'Red Lines' for suggested amendments to the Directive, published in February 2020, set out how this could be addressed.

Metrics and Targets

- All organisations disclosed at least one environmental or climate-related metric, however the degree of direct linkage between reported metrics and risks and strategy was variable, with some companies appearing to report a substantive number of indicators without clarity as to how these were used internally;
- All companies disclosed at least one GHG metric, however 24% did so without clear application of the emissions reporting scopes and 46% did not disclose any Scope 3 emissions categories; and
- 30% had linked a quantitative environmental or climate-related target, most commonly a GHG emissions target, to board or management-level remuneration.

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Recommendations

Our analysis shows that current disclosure by EU companies against the TCFD recommendations requires improvement, with many organisations yet to fully adopt the required disclosures. To address the gaps in current TCFD disclosure under the NFRD, CDSB proposes a series of recommendations for companies and for policymakers.

Recommendations for companies

1. **Clarify the materiality of environmental and climate related issues to your business**

   The TCFD recommends that the materiality of climate-related issues should be determined consistently with how organisations determine materiality for other information included within the mainstream report;

2. **Disclose climate-related information deemed to be financially material in the mainstream report**

   The TCFD calls for inclusion of information within the mainstream report. Governance and Risk Management disclosures should be provided by all organisations, with Strategy and Metrics and Targets disclosures included in the mainstream report where information is deemed material; and

3. **Align environmental and climate-related disclosures made under the NFRD with the TCFD core elements**

   This can help to improve coherence in disclosures, by reducing duplication in reporting. This will help to ensure that non-financial information provides a consistent picture, which is linked to financial information through the application of a common approach to materiality.

Recommendations for policymakers

1. **Remove the exemption allowing the non-financial statement to be reported outside the mainstream report**

   This will support accessibility, consistency and comparability of disclosures and is aligned to the TCFD recommendations, which call for disclosure of material climate-related information in mainstream report;

2. **Review the principal risk requirements of the Directive to ensure emphasis is placed on risks and impacts ‘to’ the business (not only ‘by’ the business)**

   This will ensure the risk lens set out under the TCFD is actively considered by companies, in addition to their existing disclosures on risks to the environment, which are more commonly disclosed already;

3. **Incorporate ‘climate’ into the wording of the Directive**

   This will ensure companies consider climate-related matters explicitly in their NFRD disclosures, including the associated financial impacts, in alignment with the TCFD; and

4. **Embed the TCFD recommendations into the Directive**

   Their current inclusion within non-binding guidelines is insufficient to drive full adoption of the recommendations. Directly incorporating TCFD into the mandatory requirements will drive stronger linkage of non-financial and financial reporting and is the best means of ensuring disclosure.

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c/o CDP, WeWork Sony Center
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Germany

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