ARABESQUE S-RAY RESEARCH

Global Trends

In Corporate Emissions Disclosures

Are Companies Moving Fast Enough in Reporting Greenhouse Gases?

Part One

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Global Trends in Corporate Emissions Disclosures: Are Companies Moving Fast Enough in Reporting Greenhouse Gases?

A new analysis of data from the Temperature™ Score

Over recent months, an increasing number of companies have been making commitments to reach net-zero emissions by 2050[1,2], or before. However, these commitments tend to result in more questions than answers. The scientific consensus is clear; the key to achieving the goals of the Paris Agreement, to limit global temperature rise to well below 2°C and pursue efforts to limit the increase to 1.5°C[3], lies in reducing cumulative greenhouse gas emissions. So, while these commitments are welcome and very much needed, the questions we have been asking ourselves at Arabesque S-Ray are "How much are companies currently emitting?" and "What does that mean for global temperature rise?". Using data from the Arabesque S-Ray Temperature™ Score between 2014-2019, this two-part article considers these questions in turn then examines what we can learn from recent trends in corporate disclosures.

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[1] https://www.wemeanbusinesscoalition.org/net-zero-2050/
[2] https://www.unepfi.org/net-zero-alliance/
[3] Paris Agreement, United Nations, 2015 https://unfccc.int/files/essential_background/convention/application/pdf/english_paris_agreement.pdf

How much are companies currently emitting?

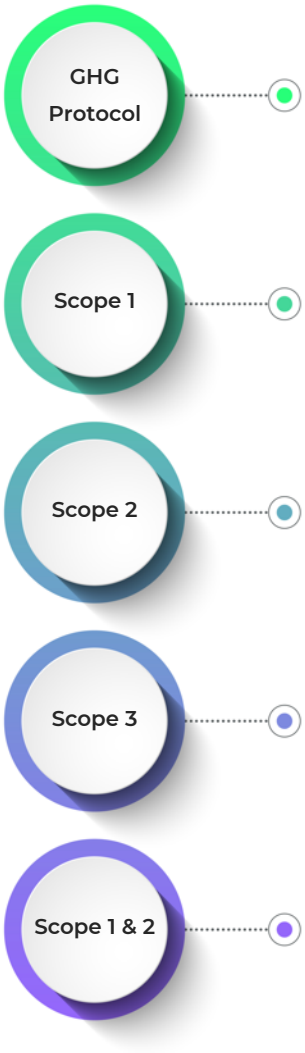
The first question is tricky to answer due, in large part, to missing or incomplete data, in particular, consistent, comparable and complete disclosure of greenhouse gas emissions data which follows the standard definitions of the Greenhouse Gas Protocol for scope 1, 2 and 3. Within the Temperature Score, we split reporting completeness into two categories. We consider the separate and full reporting of scope 1 and 2 data as the minimum amount of reporting required, and additional scope 3 reporting as a bonus. We focus on scope 1 and 2 reporting as the core data requirement because this is within the company's operational control and often more straight forward to calculate. Scope 3 emissions, however, can require both input data from outside a company's typical operations, such as from suppliers, as well as assumptions about a customer's product use, in order to provide emissions estimates across the various categories.

"Over recent years, the quantity of corporate emissions data has increased significantly."

The good news is that over recent years, the quantity of corporate emissions data has increased significantly. The bad news, however, is that in some regions the rate of increase is starting to slow. This recent stagnation in disclosures is a concern both for investors, who are wanting to make better informed decisions, and for our ability to effectively take action on climate change, as it means that we do not know how much some companies are really emitting.

Explaining the universe and methodology

The universe used for this analysis consists of the 2034 companies in the Temperature Score with a full six-year history from 2014-2019 (Figure 1). We focus on the companies domiciled in Europe, Asia and the USA, which covers around 85% of this universe. Within the universe, we include companies that are not reporting any data, as well as those reporting scope 1, 2 and/or 3 data.



The standards developed by the World Resources Institute that lay out how to calculate and report your GHG emissions. Full details of the GHG protocol can be found here: http://ghgprotocol.org/

Direct emissions from sources owned or controlled by the company. E.g. a power station, company-owned vehicles.

Indirect emissions from purchased electricity, heat or steam. E.g. heating buildings.

All other indirect emissions. These are split into 15 categories including business travel, waste generation, product end-use and investments.

This considers companies reporting on scope 1 and 2 data separately and following the definitions of the GHG Protocol, plus those that are also reporting on scope 3 data.

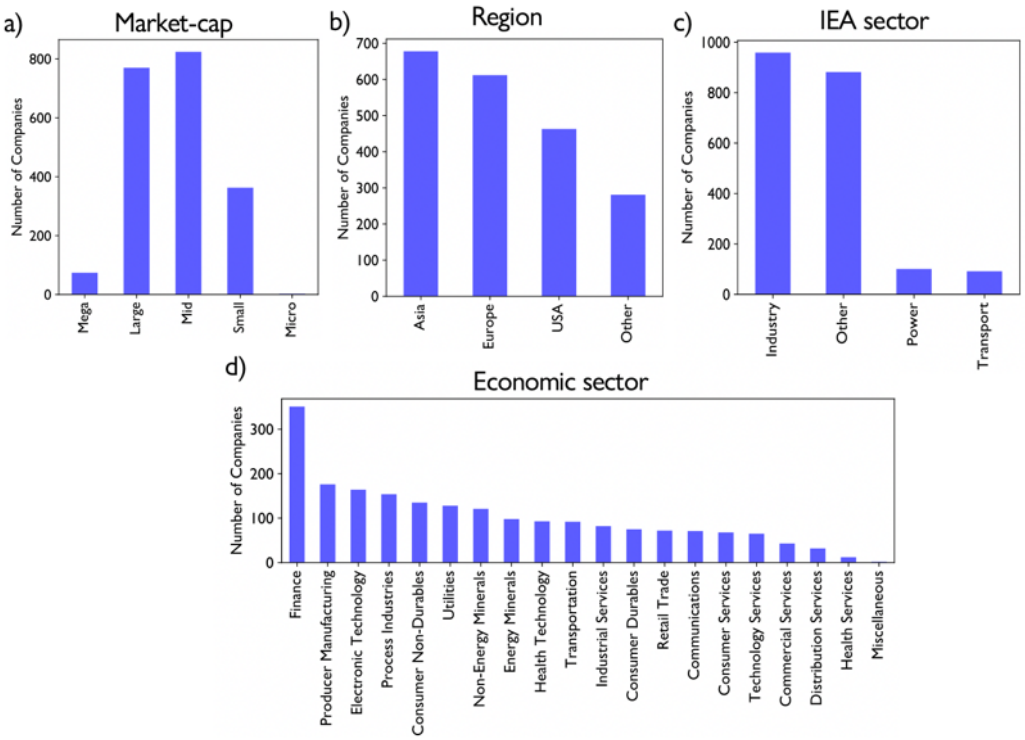


Figure 1: Universe coverage by a) Market-cap, b) Region and c) IEA sector, d) FactSet RBICS sector. Companies within the Temperature Score universe are mapped to the four IEA sectors using FactSet industry classifications. The full mapping can be found in Appendix 1 of the Temperature Score methodology. Coverage details are consistent over the 2014-2019 timeframe considered in the analysis.

Increasing emissions disclosures

Analysis from the Temperature Score shows that corporate disclosures are rising (Figure 2). From 2014 to 2019, the proportion of companies disclosing at least scope 1 and scope 2 emissions rose from 44% to 68%. However, the rate of disclosure has not been consistent across regions (Figure 2a), and has, perhaps unsurprisingly, been led by Europe (51% to 72%). What is more surprising is the recent change in second place from the USA to Asia in 2019. This is driven both by a decrease in disclosures from the USA and an increase in disclosures from Asia.

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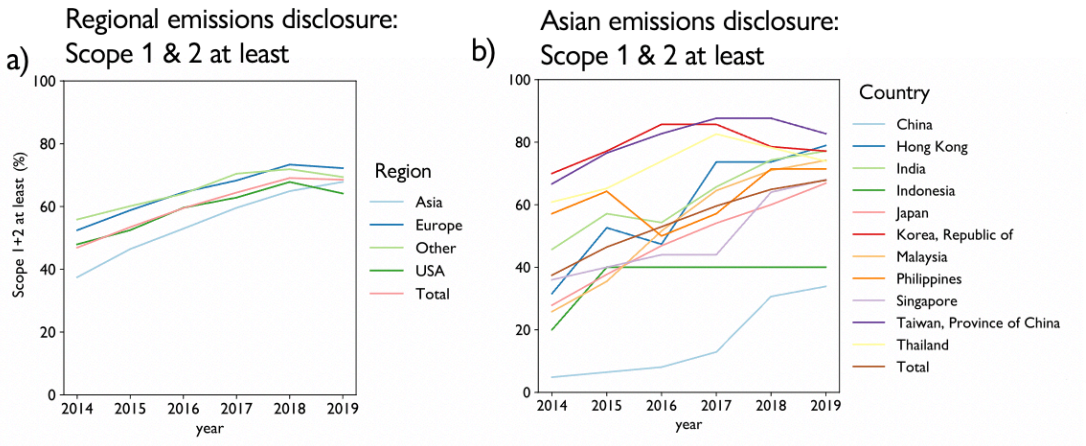


Figure 2: Percentage of companies reporting on at least scope 1 and scope 2 emissions for a) Asia, Europe, USA, Other regions and Globally, b) Countries in the Asian region where the Temperature Score has coverage of more than 10 companies.

Digging into this further, we can see that this recent increase in disclosure in Asia is region-wide, driven in particular by Japan, India, Singapore and Malaysia (Figure 2b). Meanwhile, in the USA, we find that the decrease in disclosure between 2018 and 2019 is not a result of companies stopping reporting altogether (the number of companies reporting some form of emissions data increased between these years), but rather a decrease in the number of companies reporting on both scope 1 and scope 2 emissions. We find that companies that previously fully reported their data are now reducing the amount of data provided, or providing it in a less decision-useful format. For example, by providing a sum of scope 1+2 rather than a break down by scope, or by only providing scope 1 emissions. This type of variation in data provision creates difficulties for the data users as the data is not consistent and comparable over time.

In addition to the overall trend of increased disclosures we also find that disclosures themselves are becoming more sophisticated (Figure 3), as the proportion of companies disclosing scopes 3 emissions is rising. By the end of 2019, 22% of companies reported scope 1 and 2 only, up 4% from 2014 (Figure 3a). Over the same period, the proportion of companies reporting scope 1, 2 and 3 data increased by almost 20%, rising to 46% by the end of 2019 (Figure 3b). While this trend is seen across regions, it stands out most in Asia where there was a 7% increase between 2018 and 2019 alone.

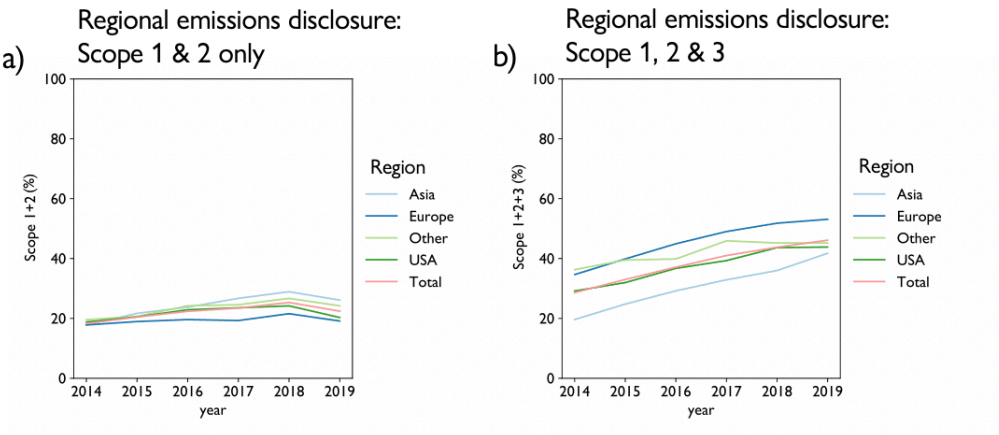
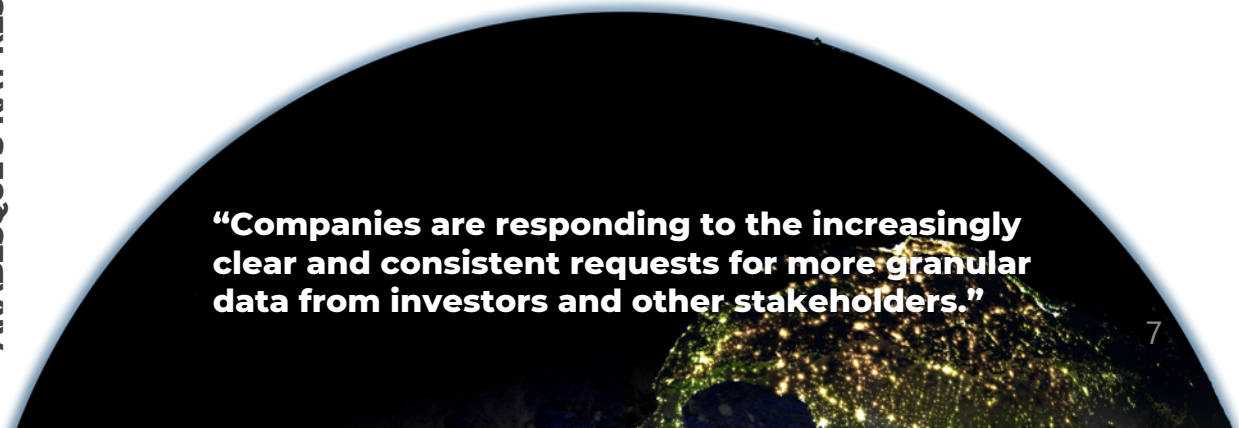


Figure 3: Percentage of companies in each region disclosing a) scope 1 and scope 2 emissions only, b) scope 1, 2 and 3 emissions.

These findings indicate two things. Firstly, it seems that companies are responding to the increasingly clear and consistent requests for more granular data from investors and other stakeholders. Secondly, that despite this development, some companies will not report until regulations require it.



Data demands and the rise of the TCFD

Companies have an overwhelming choice of frameworks and standards that they can use to report sustainability data. This can, however, lead to more data gaps than it fills. Through our in-house data collection process, we found that many well-intended attempts at being transparent resulted in data that is not useable by investors and other stakeholders.

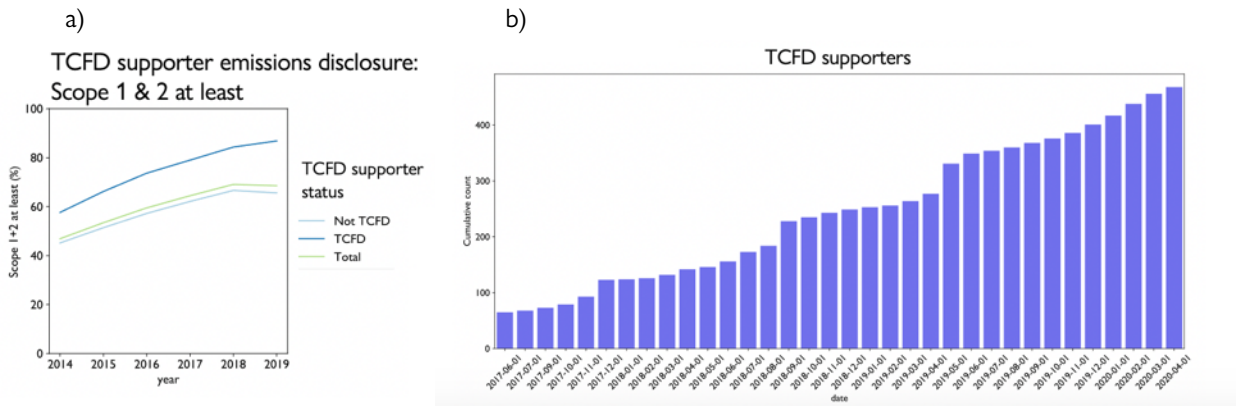


Figure 4: a) Percentage of companies that have and have not pledged their support for the TCFD recommendations as of April 2020, b) the cumulative number of companies pledging their support for the TCFD.

Emerging from amongst this are the TCFD recommendations, which bring together many of the existing frameworks and standards. Published in June 2017[4], the TCFD has quickly become the preferred framework when it comes to climate-related financial disclosures. The recommendations focus on a set of decision-useful disclosures, and greenhouse gas emissions are one of a number of metrics suggested for disclosure that make up the overall picture of a company's climate-related risks and opportunities. The framework requires emissions data to be reported in-line with the GHG Protocol, which is also the condition applied in the Temperature Score. By providing this data, and setting and meeting targets to reduce emissions, companies can show investors and other stakeholders how they are assessing and managing this risk.

[4] https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf

We find that companies that support the TCFD recommendations are significantly better at reporting than those that have not (Figure 4a). In the initial phase of the TCFD disclosures, it was expected that companies that are already reporting on climate-related issues would be able to adopt the framework easily. We see this clearly if we consider the disclosure rates of current TCFD supporters compared to non-supporters (Figure 4a).

As part of their final report in 2017, the TCFD set out a five-year implementation path for wide adoption of its recommendations. We are now three years through this, and while support for and awareness of the TCFD recommendations has grown (Figure 4b), voluntary disclosure beyond those already disclosing has been slower to increase.

The continued need for regulation

Even if there a consensus on the frameworks and standards that companies are asked to report on, there will remain a set of non-disclosing companies. Some companies will not start to publicise their data unless regulation requires them to do so. They know that in many cases, their emissions will be estimated based on their peers, and so why use resources and take on any potential risks associated with reporting this data when there is currently little incentive to do so? Until the risks of not-disclosing outweigh the risks of disclosing, which they are starting to, it will be challenging to push these companies over the transparency line.

In the USA, investors are taking on this challenge. For example, in July 2020, 40 investors with nearly $1trillion in assets under management wrote to various regularity bodies in the US to ask them to integrate climate change into their mandates[5]. Part of this ask included requiring banks to disclose the "carbon emissions of their lending and investing activities", which should, in turn, lead to higher rates of disclosure by corporates as banks start to require this data.

[5] One of the letters sent to US financial regulators, July 21st 2020: https://www.ceres.org/sites/default/files/Federal%20Regulators%20Letter.pdf

In Asia, stock exchanges, regulators and pension funds are taking the lead. Emissions disclosures are becoming increasingly mandatory or expected as requirements for listing on stock exchanges[6]. For example, companies listed on the Hong Kong stock exchange must report emissions under "comply or explain" provisions[7]. Following this, the China Securities Regulatory Commission has announced plans to require more ESG disclosure[8,9], although the implementation of these measures is not expected until the end of 2020, and has received a mixed response[10,11]. The Singapore stock exchange also has increasing ESG rules, with a requirement on the timely publication of a company's sustainability report (within five months of the end of the financial year), and a set of disclosures that closely follow those of the TCFD[12]. In Japan, GPIF (Government Pension Investment Fund) has been a key driver of increased disclosure and has raised the importance of reporting on ESG issues by actively allocating funds using ESG criteria, pledging support for the TCFD recommendations, and joining the CA100+[13].

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In the EU, regulators are also leading efforts to provide a more consistent disclosure framework aligned with the long-term goals of the Paris Agreement. The various initiatives of the EU Sustainable Finance Action Plan[14] are in the final stages of coming into law. Once in effect, these initiatives will require significant increases in the amount of non-financial data disclosed by companies operating in the EU. These disclosure provisions align with the TCFD recommendations, making a further case for the general adoption of these requirements by companies.

[6] Building on the base: TCFD disclosure in Asia (October 2018), AIGCC, http://www.aigcc.net/wp-content/uploads/2018/10/AIGCC_Building-on-the-base_TCFD-Disclosure-in-Asia_FINAL.pdf
[7] https://en-rules.hkex.com.hk/sites/default/files/net_file_store/new_rulebooks/c/o/consol_gem.pdf
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[11] https://asia.nikkei.com/Opinion/China-needs-to-untangle-its-rules-for-ESG-reporting
[12] http://rulebook.sgx.com/rulebook/711b
[13] https://www.fsb-tcfd.org/tcfd-supporters/
[14] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018DC0097

As climate-related disclosures become increasingly requested, expected and mandatory, the quantity and quality of available data will increase. We can already see how clear and consistent guidelines can help companies disclose fully and accurately. If adoption of the TCFD recommendations continues across regions and sectors, then we are hopeful that climate-related data disclosure will become the norm among global corporations. For investors and other stakeholders, this would provide a much better understanding of the climate-related risks and opportunities a company is exposed to.

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In the meantime, we must work with imperfect and incomplete data while trying to encourage the increases in transparency that are needed. These challenges are the key motivation behind the Temperature Score. We will cover analysis of the Temperature Score, along with our second question, "What does that mean for global temperature rise?", in the second part of this two-part paper.

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