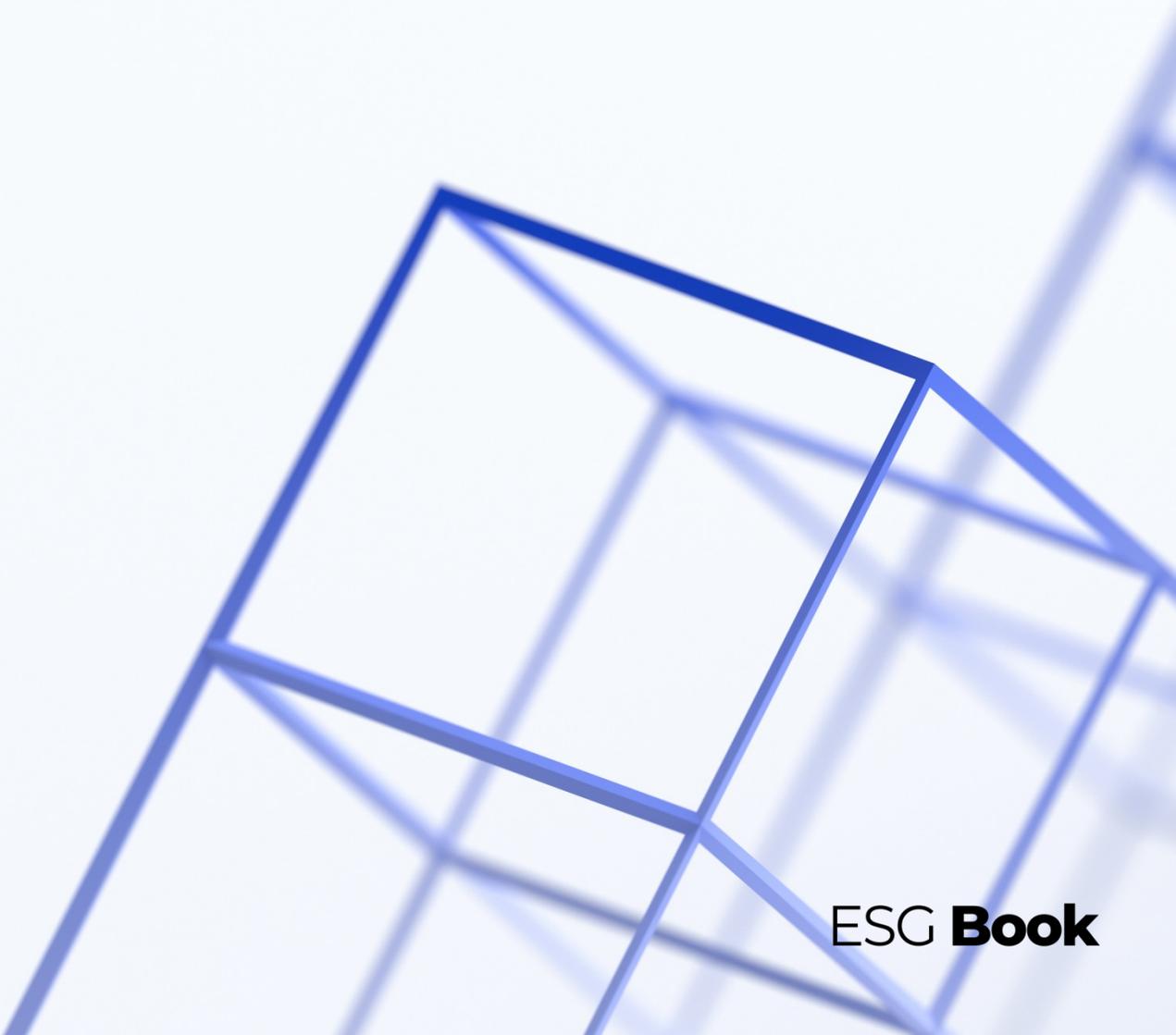


TCFD Alignment Barometer: Measuring Climate Disclosure

By Min Low and Tejeshwar Gill



ESG **Book**

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The Task Force on Climate-Related Financial Disclosures (TCFD) was established in 2015 by the Financial Stability Board to develop recommendations for more effective climate-related disclosures. In 2017, the TCFD published a set of recommendations to guide companies in providing better climate-related reporting, which has since become the global standard for climate disclosures. The TCFD Alignment Barometer, delivered through ESG Book, supports corporates and investors in understanding the TCFD recommendations and the reporting landscape.

Why are the TCFD recommendations important?

Climate has become an increasingly salient topic in recent years. As a non-diversifiable risk, climate risk is unique amongst the many risks corporates face. Economic and political risks can be mitigated by relocating business operations for instance, while supply chain risks can similarly be mitigated by engaging multiple suppliers across different geographies.

Climate change, however, is a global phenomenon that corporates cannot easily mitigate through diversification. While the severity and type of climate physical risk (such as floods, droughts, and wildfires) might differ depending on geographies, chronic physical risks (such as sustained higher temperatures) will impact the availability of natural resources as well as the quality of living and working conditions across the globe. This will adversely affect the cost of operations, location of operations, and even labour rights.

“An average of USD2.5 trillion is at risk between 2015 and 2100 due to climate change risks if we proceed with business-as-usual”¹

Corporates are steadily recognising and acknowledging that climate risk is material to their business – demonstrated by the increasing inclusion of climate in annual reports. For example, in 2020, EY found that from a sample of 1100 companies, the average company reported against 70% of the TCFD recommendations, 16% higher than the 2019 figure. Part of this increasing focus on climate can be attributed to investor pressure – in a 2018 study, 92% of investors surveyed remarked that climate change issues would affect their decisions and almost half stated that they would rule out an investment immediately on the basis of climate risk disclosures². Comparatively, these figures were 71%³ and 8%² of investors respectively in the previous year.

Climate transition risks, as well as regulatory and reputational risks, are becoming increasingly important for corporates as consumers and policymakers become more climate-aware and climate-related policies gain momentum. The TCFD recommendations then serve as a global standard for climate-related disclosures, ensuring comparability and consistency across the numerous climate disclosure legislations.

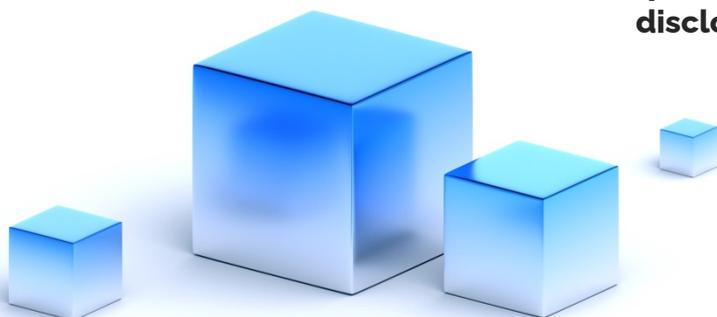
In the United Kingdom, large pension funds will be required to report on the TCFD recommendations from October 2021⁴, and mandatory disclosures will be required across the economy by 2025⁵. The TCFD recommendations are also integrated into the recently proposed Corporate Sustainability Reporting Directive (CSRD) in the European Union, which expands upon the existing Non-Financial Reporting Directive (NFRD)⁶. In Asia, the Tokyo Stock Exchange has included the TCFD recommendations as part of recent revisions to its Corporate Governance Code to encourage greater breadth and quality of climate-related disclosures^{7,8}. Similarly, in Hong Kong, listed companies in relevant sectors are mandated to report in line with the TCFD recommendations by 2025⁹, while the Singapore Exchange has proposed mandatory TCFD-aligned climate disclosures for key sectors from 2023¹⁰.

ESG Book: TCFD Alignment Barometer

While support of the TCFD recommendations has been growing, the quantity and quality of corporate climate disclosures remains unclear. Companies support the TCFD recommendations without providing TCFD-aligned climate disclosures and vice versa. The TCFD Alignment Barometer fills this gap by providing transparency on the extent of TCFD reporting, with the ultimate aim of encouraging companies to increase their TCFD-aligned climate disclosures. The quantity of TCFD-aligned corporate disclosures is assessed annually through a set of objective questions then aggregated to provide an overall score and rating alignment for each company, indicating the depth and breadth of their disclosures in an easily understandable manner.

Corporates will be able to use the TCFD Alignment Barometer and its four levels of granularity to better understand the strengths and weaknesses of their climate disclosures and how they compare to their peers. Similarly, investors can easily compare climate disclosures across a portfolio of companies without diving into individual corporate reports. Annual scoring provides a continuous overview of company alignment to the TCFD recommendations and allows investors and corporates alike to measure and track progress on disclosures. A poor or deteriorating score or rating alignment could be used as a basis for corporate engagement or as a negative screen to exclude companies that do not report on key climate issues.

“While support of the TCFD has been growing, the quantity and quality of corporate climate disclosures remains unclear.”



TCFD Alignment Barometer: Methodology

A set of 49 questions assess the extent to which a company’s annual reporting is aligned with the TCFD recommendations. Developed using various resources, including the implementation guidelines on the TCFD hub and the CDSB/SASB implementation guide, the questions are constructed to be aligned with other common reporting frameworks such as CDP, GRI and SASB.

Company disclosure is assessed against each of the 49 questions then aggregated to provide a score for each of the 11 TCFD recommendations (the Topic-Level score). This topic-level score is subsequently aggregated up to the four TCFD pillars of Governance, Strategy, Risk Management, and Metrics and Targets (the Pillar-level score), as shown in Table X below. Finally, the pillar-level scores are averaged to obtain an overall alignment score (0-100), representing the overall alignment of the company to the TCFD recommendations. An overall rating alignment is also provided, which assesses the breadth, then depth, of disclosures. Companies can receive one of seven rating alignments: Aligned, Aligning, Enhanced, Core, Foundation, Basic and Unaligned. The alignment ratings have the following criteria:

- **Unaligned** – Not report on any topic
- **Basic** - Report on at least one of the topics
- **Foundation** - Report on at least one topic in both the Governance and Risk management pillars
- **Core** – Report on at least one topic of every pillar
- **Enhanced** – Report one metric on each of the eleven topics
- **Aligning** - Report on more than 60% of the metrics in each topic
- **Aligned** - Report on at least 90% of the metrics in each topic

	Governance	Strategy	Risk Management	Metrics & Targets
PILLAR	Disclose the organization’s governance around climate-related risks and opportunities.	Disclose actual and potential impacts of climate-related risks and opportunities on the organisation’s businesses, strategy, and financial planning where such information is material.	Disclose how the organisation identifies, assesses, and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material
	A) Describe the board’s oversight of climate-related risks and opportunities.	A) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.	A) Describe the organization’s processes for identifying and assessing climate-related risks.	A) Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.
TOPIC	B) Describe management’s role in assessing and managing risks and opportunities.	B) Describe the impact of climate-related risks and opportunities on the organization’s businesses, strategy, and financial planning.	B) Describe the organization’s processes for managing climate-related risks.	B) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.
		C) Describe the resilience of the organisation’s strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	C) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization’s overall risk management.	C) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.

Table 1: TCFD Pillar and Topic level breakdown

Case Study for TCFD Alignment Barometer Analysis: Risk Management Pillar

Question

A description of how any decisions have been made to mitigate, transfer, accept or control climate related risks.

Snippet

Positioning for the transition to a low carbon future

Whilst our demand forecasting and modelling sees Australian liquid fuels demand growing over the short to medium term, albeit at a slower rate than we have seen over the past few years, we recognise that these volumes will likely decline over the longer term. As a key pillar of our corporate strategy, and leveraging our current strengths and capabilities, we are actively evaluating alternative energy and mobility options to meet our customer's needs in the future. Our current focus is on electric vehicles, biofuels, LNG and hydrogen.

How we are responding

- Scenario analysis and embedding climate change considerations into strategic and business planning processes.
- Investment in and piloting of low carbon solutions, e.g. EV charging stations and alternative fuels.
- Development of an energy transition strategy focusing on business portfolio diversification opportunities including alternative fuels and the broader energy sector.
- Gaining climate risk insights to better understand potential vulnerabilities to our business strategy including ongoing monitoring of policy, market and technology developments.

Source: <https://www.caltex.com.au/-/media/documents/caltex/environment-documents/2020-environment-documents/caltex-2019-sustainability-report.ashx> (Pages 39, 41)

Comments

The company states in their report that they have identified fossil fuel redundancy as a climate transition risk. In the snippets provided on the left, they mention several examples of transferring or mitigating climate related risks, which includes divesting from fossil fuel products that may not realise their full potential, embedding climate risks into decision making, and considering alternative energy sources.

As the company has described how they would mitigate or transfer climate-related risks, this question is thus recorded as disclosed.

FULL DISCLOSURE

Snippet

Outcomes in 2018:

- We conducted 15 shareholder engagement meetings during the fall off-season, and engaged with shareholders that proposed resolutions for inclusion in our proxy statement.
- Throughout the year, we responded to investor inquiries on a broad range of CSR topics, most often through phone briefings and email correspondence. We also responded to investor ratings and rankings including the Dow Jones Sustainability Index and MSCI to provide investors with a deeper understanding of our Environmental, Social and Governance (ESG) impacts and commitments.

Source: <https://cvshealth.com/sites/default/files/2018-csr-full-report.pdf> (Page 14)

Comments

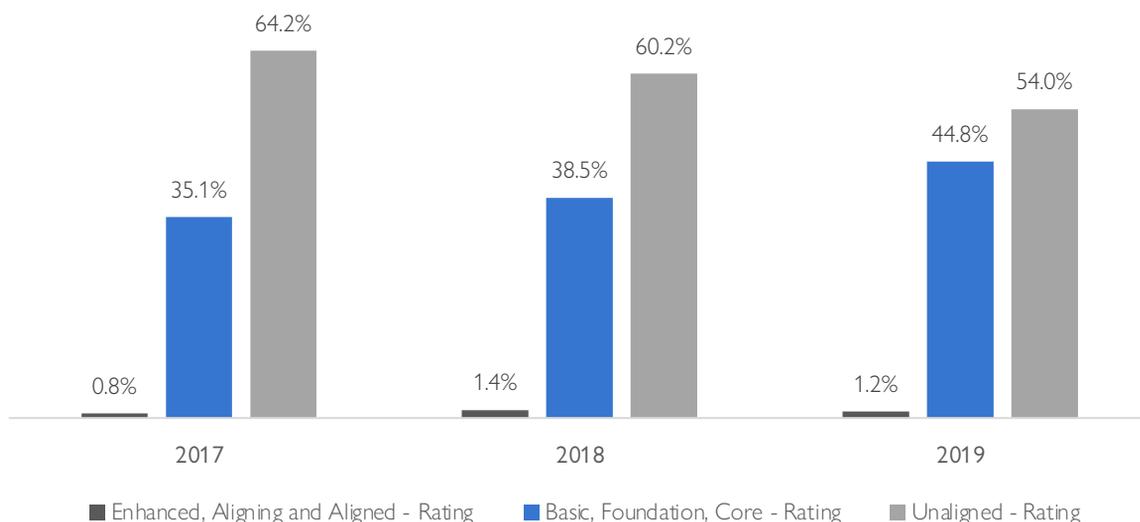
The company states on the same page of their report that climate risks are one of the top issues raised by investors and stockholders. While they have mentioned how they engaged with their stakeholders, the company has not disclosed any specific action or decision that they have made with regards to mitigating, transferring, accepting or controlling climate risks.

This question is thus recorded as not disclosed.

INCOMPLETE DISCLOSURE

TCFD Alignment Barometer: Key Findings

Summary of Disclosures

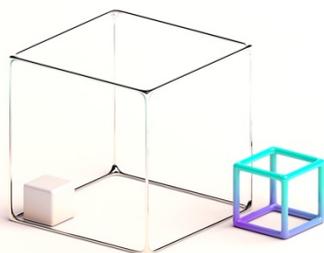


Graph 1: Alignment Rating for TCFD Alignment Barometer Universe

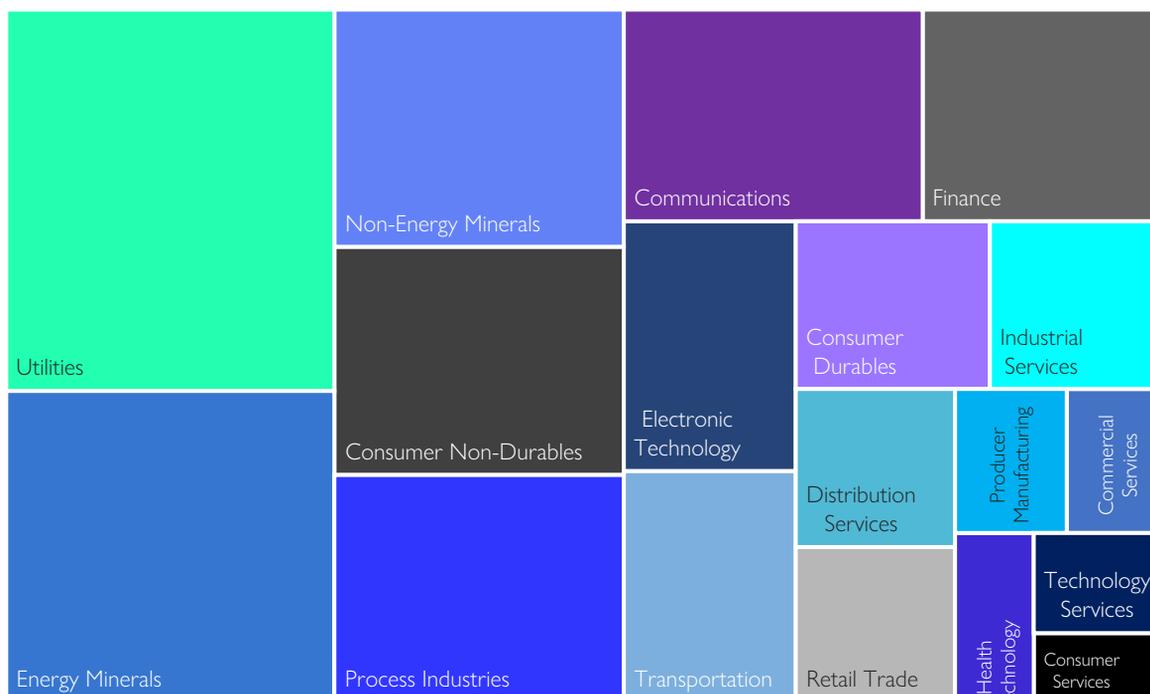
In the TCFD Alignment Barometer universe of approximately 5,000 companies, we evaluated the rating companies received. In the Graph 1, companies that received “Enhanced, Aligning and Aligned” rating is a proxy for companies reporting on all 11 topics within the TCFD recommendation and currently only 1.2% of the universe has received this rating in 2019. Companies that received “Basic, Foundation and Core” rating is a proxy for companies reporting some level of information across the 4 pillars within the TCFD recommendation and currently only 44.8% of the universe has received this rating in 2019. The majority of the universe still receives a “Unaligned” rating, suggesting they are not providing any level of data to meet the TCFD recommendation.

There has been a downward trend in the unaligned ratings received by companies, suggesting corporates are starting to look into TCFD reporting, which has been consistent with the increase in companies receiving “Basic, Foundation and Core” rating. However, this hasn’t translated into further alignment with TCFD Recommendations. On contrast, companies reporting the further granularity of TCFD recommendation fell between 2018 and 2019, primarily due to reduction in companies receiving the “Enhanced” rating, suggesting companies reduced their level of disclosure on topic level rather than pillar level. Companies receiving “Enhanced” rating dropped by 20% between 2018 and 2019, and only 8% of the companies received a rating higher than “Enhanced” in 2019 from 2018.

While evaluating the rating below “Enhanced”, we see the following trend within the industry level reporting for “Core” rating. This aligns with TCFD Status report published in 2020.



Core Rating - Industry Breakdown



Energy Materials and Utilities industries lead the reporting framework within our universe, which matches the TCFD report findings for 2019 disclosure levels for high disclosure rates for Energy sector companies¹¹.

Unaligned Rating - Industry Breakdown



Another observation within the TCFD Alignment Barometer was the high unalignment in the Health sector, with both Health Services and Health Technology scoring highly in the “Unaligned” rating for 2019. These sectors together formed approximately 13% of the total number of companies receiving the “Unaligned” rating for 2019. This was followed by Technology services sector overall forming approximately 8% of the total “Unaligned” rated companies, which matches the observation as the TCFD Status Report.

Conclusion

Climate disclosures and, in particular, TCFD-aligned climate disclosures are gaining traction worldwide. The new TCFD Alignment Barometer, available through ESG Book, provides corporates and investors with simple alignment scores and ratings to easily assess corporates' TCFD-aligned disclosures.

As corporate reporting improves, the TCFD recommendations will evolve. Improvements in the future might include assessing disclosure quality alongside disclosure quantity as well as assessing the accessibility of disclosures to investors based on where corporates choose to publish them. The TCFD Alignment Barometer will evolve along such changes, as we continue to monitor and analyse trends in climate-related reporting and disclosures.

The TCFD Alignment Barometer is a first step in our collective climate journey. Nonetheless, there is an urgent need to understand the TCFD reporting landscape now and in the future, and this tool provides a valuable lens to do so.

About the Authors

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Min is a Product Manager, specialising in ESG and Climate Solutions products at Arabesque. She holds a BSc in Physics and Philosophy from Kings College, London. Min works closely with the lead climate researchers to develop the data collection and assurance process, and frequently supports climate-focused discussions at Arabesque. She has also supported various climate campaigns at Arabesque and is active in contributing towards Arabesque's thought leadership and research papers.

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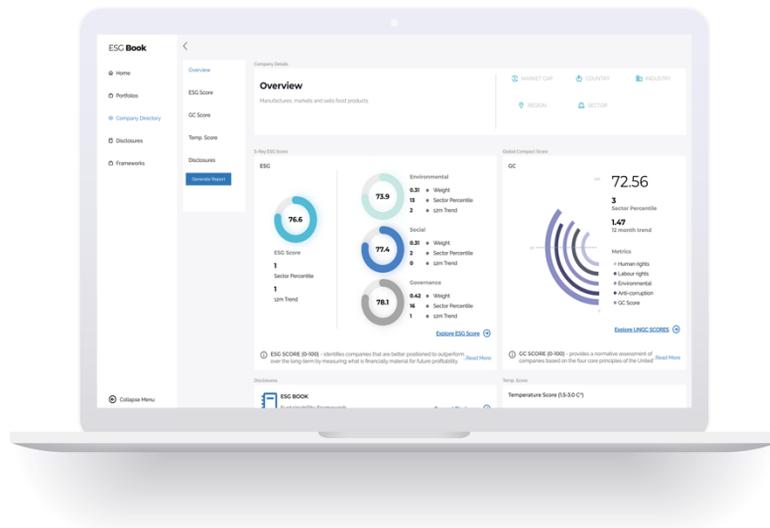
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