Towards TCFD compliance

Observations on reporting trends
May 2021
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Regulatory and investor context

The UK has an ambition to be the first country in the world to make the Task Force on Climate-related Financial Disclosures'1 (TCFD) aligned disclosures fully mandatory across the economy, with the majority of measures planned to be in force by 2023. In December 2020, the Financial Conduct Authority (FCA) issued a new Listing Rule2 requiring that, for accounting periods beginning on or after 1 January 2021, companies with a premium listing include a statement in their annual report and accounts (ARA) setting out whether they have made disclosures consistent with the recommendations of the TCFD, or to explain why they have not done so.

Complementary to the FCA’s new rule is the proposal issued by the Department for Business, Energy and Industrial Strategy (BEIS) in March 2021, to mandate climate-related financial disclosures beyond premium listed entities to other public interest entities, AIM companies, large private companies and Limited Liability Partnerships (LLPs) for accounting periods beginning on or after 6 April 2022.

The corporate governance research body, Institutional Voting Information Service (IVIS) of the Investment Association (IA), will give an ‘Amber Top3’ in its environmental, social and governance (ESG) report to all companies with year-ends on or after 31 December 2020 in sectors identified by the TCFD as ‘potentially most affected by climate change’ that do not address all four TCFD recommendations.

Momentum and activism from investor and environmental pressure groups is also on the rise. ClientEarth, an environmental advocacy group, concluded that the majority of FTSE 250 companies were not adequately reporting on climate change in the previous reporting cycle.4 This is consistent with findings from EY’s Global Climate Risk Disclosure Barometer survey over the last three years.

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1 See Appendix 1 for a summary of the four TCFD recommendations and eleven recommended supporting disclosures.
2 See Appendix 2 for FCA’s Listing Rule for premium-listed companies.
3 IVIS does not provide voting recommendations. Each report is colour coded to reflect any breaches of best practice or to highlight areas of concern. The colour showing the strongest concern is Red, followed by Amber, which shows a significant issue to be considered. A Blue Top indicates no areas of major concern, whilst a Green Top indicates an issue that has now been resolved.
4 Accountability Emergency; A review of UK-listed companies’ climate-change-related reporting (2019-20), ClientEarth, February 2021.
The ‘Say on Climate’ initiative demands that listed companies publish a plan to reach net zero emissions, including specific short-term as well as long-term targets. According to ShareAction, the “13 most important ESG resolutions” to watch during the 2021 AGM season include resolutions on climate change at Barclays and HSBC. Since its launch in December 2020, more than 40 new asset managers signed up to the Net Zero Asset Managers initiative, pledging to make their portfolios net zero by 2050 or earlier. A coalition of large investors, which include Amundi and Legal and General Investment Management, have also called on global banks to defund carbon emitters, and activist investors are taking action on companies they feel are falling short on climate ambition by calling for the nomination of new non-executive directors more capable to manage the energy transition.

The Financial Reporting Council (FRC) has included climate-related reporting as an area of focus for its corporate reporting reviews in 2021.

Objectives

Given the context above, our objective is to help premium listed companies in the UK respond to mandatory reporting requirements and investor expectations in relation to TCFD recommendations and, where disclosures have already been made, assess their maturity.

We also hope that the publication will be helpful for other companies that will fall in scope for mandatory TCFD reporting in the future, as they develop their understanding of climate risks and opportunities, embed climate considerations into strategy and risk management processes, and communicate on progress.

In February 2021, we published a short article discussing what premium listed companies could consider disclosing initially under the four TCFD recommendations (also known as pillars), given the direction of travel. Since then, we have reviewed ARAs of December 2020 reporters, monitoring the progress made so far towards TCFD compliance. This publication builds on the themes of the article and supplements them with:

- Emerging observations and noteworthy examples from FTSE 100 and FTSE 250 companies with years ending on or after 31 December 2020 to provide insight into developing practice.
- Considerations for underpinning processes to support reporting against the TCFD recommendations.
- Tips for reporting, including in respect of the integration of information across the ARA.

As we have seen previously with new reporting requirements, it usually takes about three reporting cycles for leading practices to evolve. Companies should prepare their own meaningful disclosures based on the specific circumstances of the company and use the examples in this publication as a reference – not a template.
Based on our assessment of over 100 ARAs of 31 December 2020 FTSE 100 and FTSE 250 reporters, we have summarised our emerging observations on TCFD reporting.

TCFD reporting

Below are our overall findings ahead of the implementation of the FCA’s Listing Rule:

1. Around a quarter of companies have reported at a high level against the four TCFD pillars.

2. Around half of the companies reported against all (Unilever 2020 ARA) or most (see Capital & Counties Properties 2020 ARA (pp63-65)) of the 11 TCFD recommended disclosures in their ARA or a sustainability report, with the most common missing disclosures relating to the outcomes of climate scenario analysis.

3. Some companies limited their disclosure in the ARA to a table cross-referencing the majority of the recommended disclosures to supplementary information within a separate sustainability/ESG report, and/or Climate Disclosure Project (CDP) report. A few companies such as Barclays, Standard Chartered, NatWest, EVRAZ and Rio Tinto, issued a dedicated Climate Change/TCFD report.
A common approach was to include a dedicated ‘TCFD section’, within the ARA describing the impact of climate change on governance, strategy, risk management as well as metrics and targets (NatWest 2020 ARA, pp69-83).

Some companies, like The Weir Group 2020 ARA (p66), took a more integrated approach – a separate TCFD section cross-referencing other sections of the ARA that included newly added disclosures relating to TCFD. Companies that chose this approach most often referred to governance information included in sustainability committee reports and principal risk disclosures provided as part of the broader enterprise risk management (ERM) narrative.

Very few companies translated climate risk analysis into financial reporting – the intent of TCFD. Almost no companies referenced it in their financial statements. Exceptions to this included Anglo American 2020 ARA (pp170-181) who referenced climate considerations in respect of their financial statements, and Smith + Nephew 2020 ARA (p88) which explicitly stated that there were no material impacts on their financial statements.

These statistics reflect the coverage of TCFD reporting requirements by the companies within our sample. Whilst we reference examples of leading practice, disclosures more broadly are still in their infancy. Later this year, EY will publish the 2021 EY Global Climate Risk Disclosure Barometer, assessing not just the coverage, but also the quality of climate risk reporting across a global company data set.

Figure 2.1
Coverage of TCFD reporting requirements

- 33% reporting against all 11 recommended disclosures
- 20% reporting against some, but not all of the 11 recommended disclosures
- 25% reporting against the four pillars (but not against the 11 recommended disclosures)
- 18% acknowledgement of the requirement to report next year
- 4% no reference

These statistics reflect the coverage of TCFD reporting requirements by the companies within our sample. Whilst we reference examples of leading practice, disclosures more broadly are still in their infancy. Later this year, EY will publish the 2021 EY Global Climate Risk Disclosure Barometer, assessing not just the coverage, but also the quality of climate risk reporting across a global company data set.

5 See the 2019 EY Global Climate Risk Disclosure Barometer based on a review of 2018/19 reporting from over 950 companies across a range of sectors in 34 markets.
EY’s point of view

Whilst having the TCFD disclosures in a separate section in the ARA may make the information easier to find and compare across companies, we encourage a more integrated approach. Incorporating material TCFD disclosures within key sections of the ARA, such as strategy, s172 statement and governance reporting, helps demonstrate that a company’s response to climate change is not a ‘tick box’ exercise, nor something separate to usual process, but something that is becoming embedded throughout the organisation. To help companies achieve this, we supplement our hallmarks of leading disclosures in this report with considerations on their integration across the ARA.

This approach requires a ‘TCFD cross-reference index’ containing a brief summary and/or specific page references to the relevant sections of the ARA and/or other publicly available reports to allow readers to find information relating to TCFD quickly and effectively.

We expect that as stakeholder demand for quality climate-related disclosures increases, more companies, especially those in high-risk sectors, will produce standalone TCFD reports (or have TCFD sections within sustainability reports). These will be used to provide more granular information to stakeholders, and specifically investors, on the assumptions within decarbonisation pathways, carbon budgets, scenarios, etc. For many reporters, including this level of detail in the ARA may not make it fair, balanced and understandable (FBU); but access to this information will become essential for investors to be able to consider the impact of climate change on their own portfolios.

Companies used to have a standalone Corporate Social Responsibility (CSR) report. For many, this then evolved into a separate CSR section in the ARA. Now, the majority of companies integrate stakeholder and sustainability reporting within the ARA — this is what will need to happen with TCFD reporting.

Maria Kępa, EY UK Corporate Governance Team
Practices and processes underpinning disclosures

Reporting can only ever be an outcome of the underpinning practices and processes adopted by a company. Analysing disclosures provides some insight into the progress that companies are making into embedding climate considerations across the organisation. In general, most companies are yet to comprehensively demonstrate how they are considering the range of physical climate risk and transition climate risk scenarios from a risk management and strategic perspective. However:

1. Some companies, particularly those which are more obviously exposed to the transitional climate risks, have already integrated climate governance within their existing board committees such as Health, Safety and Environmental Committees or Sustainability Committees. Others have set up new committees or internal climate-related working groups. Some address this topic directly at the board level, without explicit committee support. However, there is a lack of detail on the selection process, training or skills of members of such bodies which could give rise to concerns about the competencies of boards around climate.

2. Although many companies have announced ambitions to achieve net zero by 2050 or sooner, it is unclear whether climate considerations have been given sufficient attention on board agendas. There is limited information on whether these ambitions are underpinned by a detailed strategy or capital allocation plans, nor whether their ambition for net zero includes their full value chain.

3. Climate change is often reported as a principal or emerging risk (see Figure 2.2); however, despite this, there remains limited quantification in terms of its financial impacts. This suggests there are gaps in capabilities, data and tools, especially in relation to scenario analysis. In order to take actions now, and over the next decade, companies need to understand and disclose the overall impact over the long-term horizon. This requires using scenario analysis, without which it is difficult to consider an appropriate strategic response to climate-related risk.

In most sectors, companies are not reducing emissions fast enough to hit their 2030 targets. In no sector are companies reducing emissions fast enough to meet their 2050 targets.

Transition Pathway Initiative State of Transition Report 2021

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The Climate Action100+ Net-Zero Company Benchmark (March 2021) reveals 52% of companies assessed comprising the world’s largest corporate emitters have announced an ambition to achieve net zero by 2050 or sooner.
There remains confusion from companies as to the difference between their own net zero pathways (in line with science-based targets, for example) and the implications for the company in the context of a net zero transition. The difference is subtle but meaningful, in that some organisations themselves are low emitters, but form part of emissions-intensive supply chains that will be significantly disrupted by the transition. Once again, scenario analysis will be fundamental in establishing the full business model impacts across the organisation’s value chain.

Once companies understand the wider impacts, including material scope 3 emissions (indirect emissions on which the organisation has an impact), they should engage with their supply chain to understand how they can support and enable them with emission reductions. More companies are now incorporating a supplier’s approach to climate change as one of the requirements for working together.

Despite the increasing focus on non-financial information and market expectations for this information to be robust and accurate, only a small number of companies voluntarily sought third-party assurance of their sustainability information. It is also difficult to understand, based on current disclosures, how robust the processes that underpin the collection of climate data actually are, as they are very seldom referred to in audit committees’ internal control narrative.

In EY’s analysis of the prevalence of ESG metrics in executive incentive plans for 2016 and 2019, environmental measures have seen the biggest proportionate increase in these plans – these are mainly concentrated across the extractive, consumer and financial industries. When incorporating ESG metrics in pay, including those related to carbon, companies should be wary of the reliability of the data used to determine incentives, and the potential unintended consequences such as “hitting the target but missing the point”. For example, an excessive focus on gender diversity targets, included in pay, at the expense of the broader development of a diverse talent pipeline which also considers non-gender diversity.

7 ESG metrics in executive incentive plans, EY, March 2021.
Most companies include information on climate governance. Some companies had independent advisory committees, comprising external experts to act as a sounding board. Many reported that climate risks are the responsibility of the whole board, whilst a few named a director or the relevant committee responsible for climate-related issues. There were a number of approaches between companies at management level, such as the establishment of climate-related internal task forces or working groups. The role of management is generally articulated less clearly than the role of those charged with governance.

Hallmarks of leading practice

- Build in the oversight of the broader climate agenda and TCFD implementation into board activities, for instance, making this a standing item of meeting agendas.
- Identify the directors or committees that are responsible for the oversight and management of the company’s response to climate change (BP, see Figure 3.3).8

TCFD recommended disclosures

Describe the board’s oversight of climate-related risks and opportunities.

Describe management’s role in assessing and managing climate-related risks and opportunities.

8 As noted by the Investment Association’s Shareholder Priorities for 2021, whilst investors maintain that climate change is an issue for the whole board, naming individual board members or committees with responsibility provides essential accountability and leadership on this critically important issue.
- Identify climate-competence gaps at board and management level and develop a structured training plan, including consideration of access to third-party experts. Lloyds Banking Group 2020 ARA (p86) states that during 2021, the Group will be reviewing its skills matrix to explicitly consider environmental and climate change skills and experience.
- Include the management of climate issues as part of the board evaluation process.
- Consider putting the company’s climate transition plan to a shareholder vote, as done by a number of companies such as Unilever, London Stock Exchange and National Grid.9
- Engage with key stakeholders, including employees, customers and suppliers, to understand the potential positive and negative impacts from transitioning to a low-carbon economy.
- Clarify specifically who within management e.g., Chief Sustainability Officer (CSO)10 and/or working groups are responsible for assessing and managing climate-related risk and for supporting the board in their monitoring activities.
- Ensure involvement from the relevant functions and/or divisions across the organisation when setting up an internal climate change task force or working group – include investment, commercial and operational representation – to enable holistic considerations of climate-related issues.
- Ensure succession planning at board and senior management levels considers the necessary skills and experience required to advance the company’s climate strategy.

42% of companies (49% excluding companies in financial services) have a board committee with specific responsibilities regarding sustainability.

Hallmarks of leading disclosure

- The reports of the relevant board committees should set out how they exercised oversight over climate change related disclosures. Furthermore, for high-risk sectors, climate-related reporting should be considered as part of the board’s assessment of whether the ARA, as a whole, is FBU. We found a few companies, like Smith + Nephew 2020 ARA (p86), Shell 2020 ARA (p150) and Anglo American 2020 ARA (p119), which reference the audit committee’s consideration of climate-related matters relating to the financial statements. We did not identify any companies that provided explicit reference to climate-related matters in the wider narrative about FBU relating to the ARA as a whole.
- Explain the overall process and plan, in relation to progress towards full TCFD alignment and broader climate change targets with reference to a timeline (ITV, see Figure 3.1).
- Ensure that stakeholder engagement reporting reflects all key climate-related matters discussed with shareholders and other significant stakeholders, and the impact this had on board decision making and discussions. HSBC explains how it considers stakeholder expectations in reviewing and approving a new climate ambition (see Figure 3.7).
- Where a resolution on climate change has been passed in the year, explain the voting results and the views received from shareholders, as well as any actions taken and/or proposed by the company. In relation to a special resolution requisitioned by Climate Action 100+ on climate change disclosures, BP 2020 ARA (p27) explains the voting results, key elements of the resolution and how the company had addressed them.
- Explain how addressing climate considerations is integrated into the board structure and committees; how the board has oversight of climate change; and management’s process for considering climate-related issues, including key responsibilities and the cadence of reporting (EVRAZ 2020 Climate Change Report (p9)).
- Disclose a board skills matrix which includes climate competence (Severn Trent, see Figure 3.2).
- Where climate-related working groups or committees are set up, disclose the selection process for the climate expert or group, the expertise, skills and/or any relevant training members received.

9 The Investor Forum has called on the Government to introduce a mandatory non-binding shareholder ‘Say on Climate’ on TCFD aligned disclosure obligation.
10 The importance of the CSO role has been recognised by the creation of the S30 forum, which brings together leading CSOs to accelerate business action on sustainability. CSOs help to explain how profit and purpose can be complementary, demonstrating that environmentally-conscious organisations protect their finances as well as the planet (Why CSOs are key to value-led sustainability, Steve Varley (EY Global Vice Chair – Sustainability), February 2021).
Provide examples of specific climate-related topics discussed by relevant bodies (board and senior management levels), the potential consequences of those issues on the business, and the rationale underpinning any related decisions.

Integration across the ARA

- Include principal decisions made in relation to climate within the s172 statement (Aggreko, see Figure 3.4 and Rotork, see Figure 3.6).
- Demonstrate the consideration of climate change in governance reporting, for example, if the accountability for climate risks and opportunities was considered during evaluations of the board and its committees, the evaluation narrative should report on the findings (Capital & Counties Properties (see Figure 3.5)).

Figure 3.1

ITV 2020 ARA (pp62-66) provides a helpful TCFD progress roadmap and explanation of its environmental governance structure.

<table>
<thead>
<tr>
<th>TCFD progress roadmap</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>We have identified significant progress in improving how we manage our environmental targets and climate-related risks and opportunities.</td>
<td>Implemented the new sustainability strategy.</td>
<td>Updated environmental governance structure.</td>
<td>Obtain verification for SBT from the SBT initiative.</td>
</tr>
<tr>
<td>- Identified Group CFO as owner for climate-related risks</td>
<td>- Created Climate Change Delivery Group chaired by Group CFO</td>
<td>- Established a Climate Change Delivery Group.</td>
<td>- Completed climate scenario analysis and quantification of climate-related risks.</td>
</tr>
<tr>
<td>- Set baseline for targets, including GHGs</td>
<td>- Launched ITV’s environmental targets, including GHGs and 100% renewable electricity target by 2025</td>
<td>- Developed climate change scenario analysis for our responses in the Carbon Disclosure Project program</td>
<td>- Finalised emissions reduction roadmaps for all business areas.</td>
</tr>
<tr>
<td>- Established the Green Team Steering Group.</td>
<td>- Identified all climate-related risks and opportunity, including developing appropriate mitigation strategies.</td>
<td>- Established a Green Team Steering Group.</td>
<td>- Green Team Steering Group and Business Area Green Teams</td>
</tr>
<tr>
<td>- Established Environmental Governance structure.</td>
<td>- Developed a Green Team Steering Group.</td>
<td>- Responsible for: delivering our environmental targets, tracking progress against the targets and reporting to the ITV Board.</td>
<td>- Responsible for: delivering our environmental targets, tracking progress against the targets and reporting to the ITV Board.</td>
</tr>
<tr>
<td>- Developed a climate risk register.</td>
<td>- Developed an environmental governance structure.</td>
<td>- The group meets quarterly and comprises senior business leaders from across ITV, who also lead working groups in their respective business to deliver actions required.</td>
<td>- The group meets quarterly and comprises senior business leaders from across ITV, who also lead working groups in their respective business to deliver actions required.</td>
</tr>
</tbody>
</table>

Figure 3.1 continued
Figure 3.2
Severn Trent 2020 ARA (p83) shows a board skills matrix which includes climate competence.

<table>
<thead>
<tr>
<th>Topics</th>
<th>Olivia Garfield</th>
<th>James Bowling</th>
<th>Christine Hodgson</th>
<th>Kevin Beeson</th>
<th>Philip Remnant</th>
<th>John Coghlann</th>
<th>Dominique Reineche</th>
<th>Angela Strank</th>
<th>Sharmila Nebhrajani</th>
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<td>Regulation</td>
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<td>Technology/innovation</td>
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<td>Utility sector</td>
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<tr>
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<td>People management</td>
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<td>Commercial procurement</td>
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<td>Construction/infrastructure delivery</td>
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</tbody>
</table>
BP 2020 ARA (p53) explains the organisational structure by which management is informed about climate-related issues.

This group is chaired by the EVP strategy & sustainability (S&S) and comprises members of the bp leadership team. The group sustainability committee plans to meet on a quarterly basis to review progress within entities against the sustainability frame and decide on critical strategic positions related to sustainability that present risks or opportunities to delivery. The EVP S&S will report to the main board and committees as required.

The group operational risk committee will continue to provide oversight of safety and operational Risk management performance for the group, where appropriate, which includes sustainability-related risks such as modern slavery and severe weather.

Climate-related matters were discussed at each of the leadership team meetings in 2020, including the development of bp’s net zero ambition and aims ahead of discussion with the board.

The leadership team is supported by bp’s senior-level leadership and their respective teams, with dedicated business and functional expertise focused on climate-related matters. This includes our health, safety, environment and carbon, strategy and sustainability and group policy and economics teams.

Alignment between group, business and functional leaders is fostered through cross-functional bodies.

Climate governance: management of climate-related matters
As at 1 January 2021

<table>
<thead>
<tr>
<th>bp board level</th>
<th>bp leadership team</th>
<th>Group sustainability committee</th>
<th>Group operational risk committee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board</td>
<td>Group sustainability committee</td>
<td>Chair: EVP S&amp;S</td>
<td>Chair: CEO</td>
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<tr>
<td>Safety and sustainability committee</td>
<td>Oversight of sustainability matters.</td>
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<tr>
<td>Audit committee</td>
<td>Issues and advocacy meeting</td>
<td>Chair: EVP S&amp;S, EVP C&amp;A</td>
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<td>Remuneration committee</td>
<td>Policy and advocacy issues, including those related to climate matters.</td>
<td></td>
<td></td>
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<tr>
<td>People and governance committee</td>
<td>Corporate reporting steering</td>
<td>Chair: CFO, EVP C&amp;A, EVP S&amp;S</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Development and oversight of financial and non-financial reporting, including TCFD.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

SVP level

Sustainability forum
Chair: SVP sustainability
Focused on sustainability plans and progress. Brings together previously separate committees, including carbon steering group, policy and advocacy, and human rights.

Production & operations carbon table
Chair: SVP HSE & carbon, R&M
Focuses on the delivery of lower carbon plans in P&O – particularly in relation to net zero aims 1 and 4.

Cross bp meetings and forums
Meetings and forums to allow cross-group discussions and integration.
Figure 3.4
Aggreko 2020 ARA (p50) explains its commitment to be net zero by 2050 as part of its principal decision reporting in the s172 statement.

Assessing the potential
Committing to net-zero targets, investing in new technology and developing new solutions are challenging, time-consuming and expensive, but meeting the needs of our customers and investors, reducing emissions and clearly setting our own environmental targets is key to the long-term sustainability of Aggreko. Setting environmental targets are also important in retaining current and attracting future employees. We undertook a review of existing and emerging technologies, availability and pricing of fuels and potential combinations of technology and fuel to enable our customers during the energy transition. This gave us the confidence in our long-term ambitions and strategy.

Long-term implications
We already have a strong track record of responding to low-carbon demands: our investments in low-carbon technologies, partnerships and developing commercial systems within our Global Products and Technology division. This provides important momentum for Aggreko to take the lead in the energy transition. We have refreshed our strategic priorities for the transition to help us drive growth and address environmental concerns, while optimising our existing assets to deliver efficiencies and improve returns.

Read the four statements setting out our environmental commitments on page 07.
Read more about our sustainability strategy and engaging with stakeholders to develop our materiality matrix on page 42.

Figure 3.5
Capital & Counties Properties 2020 ARA (pp63 and 81) established a new Board Environment, Sustainability and Community Committee with oversight of environmental, sustainability and community matters in response to the prior year board evaluation findings.

2020 BOARD EVALUATION

The Company had previously committed to undertaking an externally-facilitated evaluation in 2020.

The Chairman and Company Secretary considered the approach to be taken and recommended that NJMD be engaged to undertake the evaluation.

The Nomination Committee approved the appointment of NJMD.

Each Director completed a questionnaire and structured interview with NJMD.

A report was prepared by NJMD and provided to the Board for consideration.

A NUMBER OF ACTIONS WERE AGREED

ACTIONS FOR 2020
- Ensure Board papers reflect increased focus on Covent Garden.
- Review reporting of environmental, sustainability and governance matters to the Board.

PROGRESS
- The balance of Board reporting reflects the Company’s portfolio.
- New Board E&S Committee established with oversight of environmental, sustainability and community matters.

ACTIONS FOR 2021
- Review succession plans for both the Board and the Senior Management Team.
- Keep culture and values under review to ensure that they reflect and remain consistent with the Company’s strategy.
- Ensure effectiveness of whistle-blowing engagement mechanisms.

TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES (“TCFD”)

In 2018, we committed to seeking to better understand climate-related risks to Capco’s business and prepare a response in alignment with the Task Force on Climate-related Financial Disclosures (“TCFD”). Our first disclosure is set out on the following pages.

Our work to explore climate-related risks and opportunities to the business will continue under the direction of the Company’s E&S Committee.

GOVERNANCE

Describe the Board’s oversight of climate-related risks and opportunities
The Board has established a Board Environment, Sustainability and Community Committee (“ESC”), chaired by non-executive Director Charlie Beresford, and including the Chairman, Chief Executive and Non-executive Directors, which oversee E&S activities on its behalf. The Board retains overall responsibility for the management of climate-related risks and opportunities. The Board monitors climate-related risks via the Executive Risk Committee, and has determined that climate-related risk is now a principal risk in its own right.

More information on the Board ESC Committee and the Executive Risk Committee, including the frequency of their meetings, can be found on pages 46, 48 and 75.

Describe management’s role in assessing and managing climate-related risks and opportunities
The Chief Executive, Ian Harkness, is responsible for E&S matters and chairs the E&S Executive Committee. This committee has been established to support the Board ESC Committee in assessing, monitoring and mitigating climate-related risks and acting upon climate-related opportunities. The committee includes Charlotte Hoyle, the Company Secretary; the Group Legal Director, the Head of E&S, the Director of Sustainability and Technology and representatives from the business, and is attended by our retained sustainability advisor.

Climate-related risks are separately considered by the Executive Risk Committee, as part of the risk management process based on assessments submitted by the business units and the Director of Sustainability and Technology.
Figure 3.6
Rotork 2020 ARA (p94) explains establishing an ESG committee as a principal decision in the s172 statement.

<table>
<thead>
<tr>
<th>Board Decision</th>
<th>Section 172 Factor</th>
<th>Impact on Stakeholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Establishment of Environmental, Social and Governance Committee</td>
<td>Consequences of decisions in the long term</td>
<td>Investors are looking for companies that prioritise the environment, are committed to diversity and inclusion and have robust ESG commitment and compliance policies. A key objective of the ESG Committee is to ensure that ESG is an integral part of the Company’s strategy and culture from the top down. ESG performance is also an important part of the executive directors’ personal strategic objectives and features in the annual bonus scheme for senior leaders.</td>
</tr>
<tr>
<td></td>
<td>Fostering Business Relationships</td>
<td>We continue to work with our customers to reduce their carbon footprint. Our comprehensive product and services portfolio and industry knowledge mean that customers rely on us to help them deliver reliable, energy efficient solutions that minimise their environmental impact.</td>
</tr>
<tr>
<td></td>
<td>Acting Fairly between shareholders</td>
<td>Ensuring a balance between running responsible and profitable operations, improving health and safety for our employees, and safeguarding the environment.</td>
</tr>
<tr>
<td></td>
<td>Community</td>
<td>Investing in job creation, utilising local talent and supply chains. Helping to support and grow the communities in which we operate at the grassroots-level and establishing Rotork as a global company with local roots.</td>
</tr>
<tr>
<td></td>
<td>Environmental Impact</td>
<td>Promoting energy efficiency – both in our own and our customers’ operations. Reducing emissions through defining and implementing our decarbonisation strategy.</td>
</tr>
<tr>
<td></td>
<td>Reputation</td>
<td>Demonstrating ethical behaviour and high levels of integrity.</td>
</tr>
</tbody>
</table>

Figure 3.7
HSBC 2020 ARA (p24) explains how it considered stakeholder expectations in reviewing and approving a new climate ambition.

During the year, the Board reviewed and approved a new climate ambition for the Group.

In reviewing and approving a new climate ambition, the Board acknowledged that ESG issues have developed significantly over recent years, and such issues are now recognised by stakeholders as key elements and risks for businesses to manage.

In May 2020, the Board conducted a detailed review of stakeholder expectations and was advised of key stakeholders impacted by the proposed climate strategy and the leading role HSBC was expected to take. This included a comprehensive market update on current positions taken by non-government organisations, investors, competitors, regulators and increased societal awareness.

As part of the review, HSBC’s climate advisory panel – consisting of representatives from non-government organisations, clients and academics – was consulted in the development and drafting of the new climate ambition. Wider stakeholder engagement was undertaken to help inform the Group’s position from a customer perspective including the HSBC Sustainable Financing and Investment Survey 2020 and the HSBC Navigator survey.

In the course of the Board’s discussions, it considered stakeholder feedback in the context of our business mix and the need to work towards an orderly transition, given current exposures to fossil fuels assets. The Board acknowledged the opportunity to help support our customers with their transition to lower carbon emissions and to manage other expectations and matters impacting our shareholders, employees and local communities.

In addition, the Board noted that HSBC had been recognised as a leading bank for sustainable finance and acknowledged increased competitive activity. As a result, it was conscious of the need to maintain the Group’s leadership in this area.

In making its decision, the Board recognised investors’ expectations for HSBC to continue to make progress on climate change, as it provides sustainable finance and investment and gradually reduces exposure to high-carbon assets on a timeline aligned with the Paris Agreement.
Many companies in our sample provided the descriptions of climate-related risks and their impact under the TCFD Risk Management pillar. However, strictly speaking these recommended disclosures relate to the TCFD Strategy pillar, with the Risk Management pillar being focused more on the climate-related risk process itself and its integration with the wider risk management process.

Attributing disclosures to the appropriate TCFD pillar will help promote consistency in reporting, however we recognise that integration with the broader front half narrative may result in varied practice developing in this respect in the context of UK corporate reporting. Ultimately, ensuring that adequate attention is given to improving processes, making the required disclosures and taking meaningful action in response to climate change are more important than the placement of those disclosures.

**TCFD recommended disclosures**

- Describe the climate-related risks and opportunities the organisation has identified over the short, medium and long term.
- Describe the impact of climate-related risks and opportunities on the organisation’s businesses, strategy and financial planning.
- Describe the resilience of the organisation’s strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.
Description of climate-related risks

Companies within our sample have taken different approaches to determining the categorisation of climate risk (See Figure 2.2 regarding how companies categorise climate change within their risk disclosures):

**a**

**Principal risks:** Some companies chose to disclose climate change (Anglo American 2020 ARA, p55) or another climate-related heading (e.g., “sustainable aviation” by International Airlines Group (IAG) 2020 ARA, p52) as a standalone principal risk. Others included climate change as a component of another principal risks (e.g., technology and business resilience, RELX 2020 ARA, p62).

**b**

**Emerging risks:** Some companies disclosed climate-related matters as emerging risks, whilst a few chose to elevate climate change from an emerging to a principal risk this year (Fresnillo 2020 ARA, p112).

**c**

**Cross-cutting risk:** The Climate Change Risk Forum Guide 2020 for financial firms notes that good practice is to treat climate change risk as a transverse or cross-cutting risk rather than a standalone risk. This was the approach taken by Standard Chartered which, in its 2020 ARA (p116), removed climate-related transition and physical risks and classified climate risk as a cross-cutting risk.

The impact and assessment of climate-related risks will differ depending on the business model and industry, and even within the same sector, views can be different. In our view what is most important is for companies to meaningfully describe how climate risk will crystallise for their business, locations and assets.

**Impact on strategy and financial planning**

There is limited disclosure explaining how business strategies and capital allocation plans have been adapted and changed to align with the net zero transition.

**Scenario analysis**

Scenario planning, including ambitious 1.5°C pathways\(^{11}\), is often missing. In line with TCFD’s recommendation\(^ {12}\), we encourage companies to consider a phased approach to disclosure – rather than deciding not to disclose at all. For example, start by providing broader, qualitative information on climate-related risks and opportunities as it becomes available and follow with more specific, quantitative data and information over time.

Financial statements are to a great extent focused on past performance and any underlying assumptions have to withstand the auditor’s scrutiny. This makes linking the ‘front half’ considerations of future impacts of climate change to the financial statements difficult.

It is therefore not surprising that some climate-related matters are not translated effectively into the financial statements — which is why scenario analysis, with clearly disclosed assumptions, is so important to investors.

Assumptions are very often drawn from industry bodies, e.g., the International Energy Agency (IEA) for oil and gas companies, but sometimes that means they are not sufficiently balanced or the range of inputs is not sufficiently broad.

In a similar way that the auditor challenges assumptions underpinning impairment considerations, we would like to see the auditor challenge the assumptions used by companies in their scenario analysis and report its findings.

Lloyd McAllister, Responsible Investment Analyst, Newton Investment Management

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\(^{11}\) Climate Action 100+ Net Zero Company Benchmark, Climate Action 100+, March 2021.

\(^{12}\) 2020 Status Report, TCFD, October 2020. For further guidance published by TCFD on October 2020 in relation to scenario analysis for non-financial companies, see [here](#).
Hallmarks of leading practice

- Establish what the business considers to be the relevant short, medium and long term time horizons, taking into account that climate-related issues often manifest over longer periods.
- Consider climate-related opportunities, which may include:
  - Decisions that reduce the embodied carbon of products used
  - Innovations that reduce the operational carbon emissions
  - Renewable energy generation and procurement
  - Transport and distribution network optimisation
  - Use of climate bonds and sustainability-linked loans
  - Strategic partnerships to advance climate strategy
- Consider climate-related risks, which may include:
  - Increased insurance premiums and potential for reduced availability of insurance on assets in high-risk locations
  - Reduced demand for goods and services (e.g., due to shifting customer preferences)
  - Increased production costs (e.g., inputs such as energy, water and output requirements such as waste treatment)
  - Re-pricing of assets (e.g., land valuations)

- Write-offs, asset impairment and early retirement of existing assets due to policy changes
- Consider climate risks throughout the value chain, including the supply chain. Supply chain emissions are on average 11.4 times higher than operational emissions and supplier engagement continues to remain the exception rather than the norm.  
- Consider the specific potential climate-related issues arising in each time horizon that could have a material financial impact on the organisation.
- Use scenario analysis to understand potential major business risks and opportunities under different time horizons. Include a range of scenarios, including a 2°C pathway within climate scenario planning (Unilever, see Figure 4.3). It may be possible to leverage climate modelling done by stakeholders such as the local council and insurers.
- Develop a strategic response to climate-related financial risk informed by scenario analysis/stress tests. A longer-term view than the typical business planning cycle (i.e., three to five years) needs to be considered, in addition to short and medium-term risks arising from the transition.
- Integrate the consideration of climate-related data into decision making in respect of the strategic business plan and budget. Align future capital expenditures with the net zero transition and the company’s long-term climate ambitions.

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14 As a follow-on from the Brydon report, the Government is considering whether companies should be required to produce an annual Resilience Statement to assess the prospects and challenges of the business model over the short, medium and long term, including the impact of climate change. See consultation on restoring trust in audit and corporate governance, BEIS, March 2021.
Hallmarks of leading disclosure

- Describe what the business considers to be the short, medium and long term horizons, and associate climate-related risks and opportunities with the relevant time horizons (*Polymetal*, see Figure 4.1).
- If climate change has not been identified as a principal risk, explain how directors challenged this outcome and the basis for their conclusion.
- Disclose the likelihood and impact of climate-related principal risk(s) and the significance of climate-related risks relative to other risks.
- Distinguish between physical risks (acute and chronic) and transition risks (policy and legal, technology, market and reputation) (*Polymetal* (see Figure 4.1) and *AstraZeneca* (see Figure 4.2)). Specify the assets or location of operations most impacted by climate-related risk.
- Disclose the impact on the business and strategy on areas such as products and services, investment in research and development and operations (*Rotork*, see Figure 4.6).
- Disclose the impact on financial planning (*Polymetal*, see Figure 4.1) on areas including operating costs, capital allocation and access to capital, including where carbon reduction targets have been set.
- Ensure disclosures on scenario analysis include the rationale for the scenarios selected, detail on the assumptions made in these scenarios, and the implications on resilience. Explain the impact of scenario analysis on board strategic decisions and financial planning.

Integration across the ARA

- If the ARA contains a ‘market context’ section, cover the broad economic dynamics which the business is most sensitive to, including carbon pricing considerations, an assessment of the impact on supply and demand for your products/services etc. (*Rotork* 2020 ARA, p13).
- Explain how climate change considerations have impacted your strategic priorities and business model.
- Discuss how climate transition impacts your competitive advantage or investment case (*Glencore*, see Figure 4.4).
- When discussing business performance, explain the actions taken/planned to increase resilience within the business model in order to respond to negative impacts of climate change (*Persimmon* 2020 ARA, p67).
- Address climate impacts on your future investments within capital allocation disclosures (*BP*, see Figure 4.5).
Polymetal 2020 ARA (pp58 and 59) describes its time horizons for assessing risks. It also sets out the significance level (high, medium or low) for each climate-related risk and their areas of impact on the business at a high level.

Polymetal Climate Change Report 2021 (p32) provides detail on its climate-related capital expenditure, including its overall capital expenditure estimate for green projects for 2021-30.

We have mapped each scenario above across three timeframe horizons:

<table>
<thead>
<tr>
<th>Scenarios</th>
<th>Time horizon</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business as usual (&gt;2 degrees)</td>
<td>&lt;1 year</td>
</tr>
<tr>
<td>Sustainable development (1.5 degrees)</td>
<td>1–5 years</td>
</tr>
<tr>
<td>Paris Agreement scenario (&gt;2 degrees)</td>
<td>Life-of-mine (&gt;5 years)</td>
</tr>
</tbody>
</table>

### Translational
- **Risk:** Limiting GHG emissions at national and international levels
- **Impact:** Carbon tax payment, fines for non-compliance with legislation or emission standards

### Physical

<table>
<thead>
<tr>
<th>Acute (short/medium term)</th>
<th>Chronic (life-of-mine (mosascale))</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk: Thermokarst processes in permafrost areas</td>
<td>Risk: Thawing of permafrost</td>
</tr>
<tr>
<td>Impact: Facility damage, increased operating costs</td>
<td>Impact: Facility damage, increased operating costs</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Hurricanes</th>
<th>Flooding and longer flooding sessions (change in hydrological cycles)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk: Power line breakages</td>
<td>Impact: Increased operating costs</td>
</tr>
<tr>
<td>Impact: Power line breakages</td>
<td>Impact: Increased operating costs</td>
</tr>
</tbody>
</table>

### Increase in the cost of carbon-intensive resources
- **Impact:** Increased operating costs
in 2020, we conducted a screening study of two future climate scenarios to explore our physical climate-related risks (flooding, water scarcity, extreme heat, drought and wildfires). Our analysis showed that these risks would be impacted by local conditions (based on emissions from the fossil fuel industry) and that the physical climate-related risks will be influenced by these local conditions, such as extreme heat, drought and wildfires. The screening study also indicated that, if current trends continue, the physical climate-related risks will become more severe in the years to come.

In 2017, we identified a number of risks associated with the transition to a low-carbon economy. For example, the risk of decreased demand for our products as a result of increased regulatory requirements or increased consumer preference for low-carbon alternatives. In response, we invested in research and development to develop new products and services that align with the goals of the Paris Agreement and the transition to a low-carbon economy. We also implemented strategies to reduce our environmental footprint, such as increasing the use of renewable energy sources and improving our waste management practices.

In 2020, we continued to evaluate our physical climate-related risks and the potential impacts of climate change on our business. We identified a number of potential impacts, including

- Increased frequency of extreme weather events
- Increased frequency of natural disasters
- Changes in agricultural patterns
- Changes in water availability
- Changes in biodiversity

We also identified potential opportunities, including

- Potential for new product development
- Opportunities for cost savings
- Opportunities for brand differentiation

We have developed a comprehensive strategy to manage our physical climate-related risks, which includes

- Setting clear targets and indicators for reducing our environmental footprint
- Implementing a robust risk management framework
- Investing in research and development to develop new products and services
- Engaging with stakeholders to raise awareness of the risks associated with climate change

Towards TCFD compliance

We are committed to implementing the recommendations of the Task Force on Climate-related Financial Disclosure (TCFD) to enhance the transparency of our climate-related risks and opportunities. As part of this commitment, we have

- Disclosed our climate-related risks and opportunities in our annual report
- Integrated climate-related considerations into our strategic planning and decision-making processes
- Engaged with stakeholders to raise awareness of the importance of climate change and the need for action

We believe that by implementing these recommendations, we can better manage our climate-related risks and opportunities, and contribute to a more sustainable future.
Understanding financial impact scenario analysis

Scenario analysis helps us understand the potential impact of climate-related uncertainties on our business and helps inform our strategy and financial planning. We use two types of scenario analysis:

1. Modelling the potential financial impact of average global temperature increases of 2°C and 4°C on our business in 2050.

2. Deep-dive analysis of the potential financial impact on key agricultural commodities (i.e. soybean, black tea and palm oil).

We plan to extend our scenario analysis to assess the impact of 1.5°C temperature rises to reflect the latest science and our commitment to limit global temperature increases, to well below 2°C and ideally no more than 1.5°C above pre-industrial levels.

1. Modelling the potential financial impact of 2°C and 4°C temperature increases on our business

We have made a high level assessment of the impact of 2°C and 4°C temperature increases due to climate change by 2100. Carried out in 2017, the assessment focused on the material impacts on our business in the year 2030. The modelling assumed that our business activities are the same as they are today. The scenarios were based on existing internal and external data. While we understand that policy risk and physical risk can happen simultaneously, we made the following simplifying assumptions:

- In the 2°C scenario, we assumed that in the period to 2030 society acts rapidly to limit greenhouse gas emissions and puts in place measures to restrain deforestation and discourage emissions (for example implementing carbon pricing at $75-$100 per tonne, taken from the International Energy Agency’s 4°C scenario). We have assumed that there will be no significant impact to our business from the physical impacts of climate change by 2100 – i.e. from greater scarcity of water or increased impact of severe weather events. The scenario assesses the impact on our business from regulatory changes.

- In the 4°C scenario, we assumed climate policy is less restrictive and emissions remain high to the physical manifestations of climate change increase. It results from greater scarcity of water or increased impact of severe weather events. The scenario assesses the impact of our business from regulatory changes.

The main impacts of the 4°C scenario are as follows:
- Increased frequency of extreme weather events and floods cause increased incidence of flooding to our manufacturing and distribution networks.
- Increased impacts of extreme weather events reduce economic activity, GDP growth and hence seasonality levels.
- Temperature increases and extreme weather events reduce economic activity, GDP growth and hence seasonality levels.

The main impacts of the 4°C scenario are as follows:
- Climate and metabolic stress reduces agricultural productivity in some regions, reducing prices of raw materials.
- Increased frequency of extreme weather events and floods causes increased incidence of flooding to our manufacturing and distribution networks.
- Increased temperature impacts on other agricultural commodities such as soybean, black tea and palm oil.

We selected these commodities because of their strategic importance to our business, the large volumes we purchase and the availability of data.

We first piloted a methodology for soybean in 2018 and in 2019 we’ve worked with the International Institute for Climate Impact Research to develop models for black tea and palm oil. Our methodology forecasts future yields using crop-specific and climate models. The model price uses a range of supply and demand drivers to determine the impact of changes in yield from the risks of climate change, isolating other factors such as acreage and technology on price. Three modelling steps were performed:

- Yield estimation: We analysed multiple crop and climate models to provide a wide range of expected yields in key growing regions.
- Price relationship: An econometric model was developed, based on an analysis of the raw material’s market and historical trends, to estimate the impact of climate-induced yield changes on future prices. The model seeks to isolate the impact of yield changes on prices from other important factors such as sourcing, farming practices, climate change events and man-made factors such as elections and governmental policy.

Towards TCFD compliance

Unilever 2020 ARA (pp52-53) describes the two scenarios used in its analysis:

1) Modelling the potential financial impact of 2°C and 4°C temperature increases on its business and;

2) Deep-dive analysis of the potential financial impact on key agricultural commodities (i.e. soybean, black tea and palm oil).

Towards TCFD compliance

We are one of the largest buyers of palm oil in the consumer goods industry, it is an important raw material for many of our brands, including in food, beauty and household cleaning products.

What we modelled:
We worked with Paterson Mackie for Climate Impact Research to develop suitable climate models to modelled yields in Malaysia, Indonesia, and Malaysia, where palm oil is produced, along with four other countries. The palm oil market operates globally so we used a single model, the model is characterised by high monetary yield (allowing relatively stable prices), substitution with other oilseeds such as sunflower oil, and government regulations on biodiesel. The price model, correlated for these factors and the modelled outputs were tested against yields in yield from the direct impacts of climate change on palm oil yields. Impact on yields: Likely increase in palm oil yields due to CO2 fertilization in all countries modelled over the 2038 to 2058 period, leading to between 18% and 42% lower palm oil prices.

Risk profile: Low direct financial risk to our business.

Key risks:
Potential indirect risks from extreme weather events, which can’t yet be sufficiently modelled. More palm oil is produced, and more needs to be traded, but concern about deforestation could lead to changing regulations on land use that could limit growth and impact prices. For example, in Malaysia and Indonesia, the total land available for palm oil plantations is being rapped or new plantation licenses have been halted. Despite the potential financial impact to Unilever from deforestation regulation, we support policies that tackle deforestation associated with palm oil.

We are highly concerned about deforestation associated with palm oil, the deforestation is essential to improving the sustainability of palm oil and land-use restrictions are a positive development. Palm oil could also be increasingly used for biofuel, as it provides a cheap feedstock for production.

What we modelled:
We worked with Paterson Mackie for Climate Impact Research to develop suitable climate models to modelled yields for Indonesia and Malaysia, where palm oil is produced, along with four other countries. The palm oil market operates globally so we used a single model, the model is characterised by high monetary yield (allowing relatively stable prices), substitution with other oilseeds such as sunflower oil, and government regulations on biodiesel. The price model, correlated for these factors and the modelled outputs were tested against yields in yield from the direct impacts of climate change on palm oil yields. Impact on yields: Likely increase in palm oil yields due to CO2 fertilization in all countries modelled over the 2038 to 2058 period, leading to between 18% and 42% lower palm oil prices.

Risk profile: Low direct financial risk to our business.

Key risks:
Potential indirect risks from extreme weather events, which can’t yet be sufficiently modelled. More palm oil is produced, and more needs to be traded, but concern about deforestation could lead to changing regulations on land use that could limit growth and impact prices. For example, in Malaysia and Indonesia, the total land available for palm oil plantations is being rapped or new plantation licenses have been halted. Despite the potential financial

Impact on Unilever from deforestation regulatory, we support policies that tackle deforestation associated with palm oil.

We have significant corporate reputation risks associated with deforestation. The Unilever’s policy on deforestation is essential to improving the sustainability of palm oil and land-use restrictions are a positive development. Palm oil could also be increasingly used for biofuel, as it provides a cheap feedstock for production.
INVESTMENT CASE

Our unique portfolio enables the transition to a low carbon economy. As a CO2e total emissions reduction leader, our strategy is Paris aligned across key milestone dates, with the ambition of achieving net zero by 2050.

- Future demand patterns are likely to favour the commodities that facilitate the decarbonisation of energy usage.
- We are a major producer of the commodities (copper, cobalt, nickel and vanadium) that currently underpin the infrastructure and battery chemistry likely to power electric vehicles and energy storage systems.
- Leading climate strategy targeting a 40% reduction in total CO2e emissions by 2035, and 2050 net zero ambition for Scope 1+2+3 emissions.
- Responsible stewardship of declining coal business over time as industry decarbonises.
- Decarbonisation pathways require our transition enabling commodities.
Investment governance and evaluating consistency with the Paris goals

Governance
BP’s investments fall within a governance framework. This seeks to ensure investments align with our strategy, fall within our approved financial frame, and add shareholder value. The governance framework also provides for investments to be assessed consistently, and against a range of criteria relevant to our strategy, including a range of environmental and sustainability factors.

Investments follow an integrated stage-gate process designed to enable us to choose and develop the most attractive investment cases. A balanced set of investment criteria is used, see page 39. This allows for the comparison and prioritisation of investments across an increasingly diverse range of business models.

The governance framework also specifies that proposed investments are reviewed against capital for projected operational emissions, and are subject to assessment by functions independent of the business before a final investment decision (FID) is taken.

See page 85 for more information on BP’s governance framework.

Resource commitment meeting
For capital investments above defined financial thresholds for organic or inorganic spend, the investment approval is conducted by the executive-level resource commitment meeting (RCM), which is chaired by the chief executive officer. The RCM reviews the merits of each proposed investment case against a balanced set of criteria and considers any key issues raised in the assurance process.

The CAF024 resolution requires BP to disclose how we evaluate the consistency of new material capex investments with the Paris goals and a range of other outcomes relevant to the strategy. In evaluation of consistency of such investments with the Paris goals was undertaken by the RCM for new material capex investments sanctioned in 2020, see page 31. BP’s evaluation of an investment’s consistency with a range of other relevant outcomes is achieved by considering its merits against BP’s balanced investment criteria as described on page 31.

The role of the board
The board assesses the impact of portfolio changes, such as strategic acquisitions and the allocation of capital. It also considers specific investment cases which have been approved by the resource commitment meeting, see page 29.

In 2020 three new material capex investment decisions qualified for evaluation of Paris consistency, using our materiality threshold of $250 million.

Horseshoe development
Three-well tie-in to the existing Na Kika infrastructure in the US Gulf of Mexico.

Shafag-Asmali exploration well
Gas exploration well in the Shafag-Asmali field in Azerbaijan.

US offshore wind acquisition
Entry into the US offshore wind market through a strategic partnership with Equinor to develop four assets in existing wind zones.

In addition, because there was an unusually low number of new material capex investments in 2020, we also decided to evaluate the Paris consistency of the four largest new capex investments which fell below our materiality threshold:

Lambert Deep GWF-3
Four-well tie-back to the existing Kamikaze gas plant in Australia.

Gattameya Shallow
Additional spend to bring the Gattameya gas field in Egypt on line.

Isabela 3
Single well tie-in to the Na Kika platform in the US Gulf of Mexico.

Galapagos Deep West well
Exploration well in “Olistiolitic Thrust” play in the US Gulf of Mexico.
Sustainability
Rotork’s approach to sustainability is embedded in our Purpose: ‘keeping the world flowing for future generations’. We have sharpened our focus on our sustainability agenda this year, recognising its potential to support a competitive advantage and create sustainable value for all of our stakeholders.

Strategic initiatives
- **ESG Committee formed.** We established a formal Environmental, Social and Governance Board Committee and appointed our first Head of ESG and Sustainability.
- **Adoption of the UN SDGs.** We adopted the United Nations Sustainable Development Goals to help guide our sustainability strategy.
- **Sustainability framework put in place.** We developed a framework around priority sustainability issues and selected SDGs, having undertaken a materiality assessment (see opposite and page 57 for details).
- **SDGs chosen.** We will target five main SDGs (6, 7, 9, 12 & 13) where we have greatest potential to make a difference. We have also adopted Goals 5 & 8 to help drive progress on these issues.

Progress in 2020
- **People & Environment Report published.**
- **Further embedded sustainability considerations in our innovation and New Product Development processes.**
- **Reduced our scope 1 & 2 carbon emissions by 38% and water consumption by 4.8%.**
- **Globally across our workforce, women make up 21.1% of our people (37.5% of our Board).**
- **Our employees gave time and money to charities and good causes all around the world.**
- **We committed to a Real Living Wage Policy.** We delivered four employee ‘voice’ surveys with an average engagement score of 7.1.

Read more on page 14
Simply reporting against TCFD is not going to bring about the change that is so urgently needed. Non-executive directors (NEDs) need to challenge management to really get to grips with the carbon footprint of the business – i.e. where we are today, including scope 3 emissions, and devise a strategy that clearly prioritises actions including how they will be funded. NEDs need to demand to be brought into the conversations as the CEO is shaping the plan and when the trade-offs are being debated rather than waiting to critique the final output or having assumptions made about the level of risk that the board might or might not be willing to accept. This may feel uncomfortable because of the complexity of climate change considerations and it is also a change in the way we have done things to date; but the speed with which we need to see improvements demands radical changes in the way we conduct our business and run our boards.

Susan Hooper, Plural NED and chair on multiple boards for over 20 years and a founding director of Chapter Zero*

* An organisation dedicated to providing education, insight and support on climate change to non-executive board directors.

View from EY Climate Change and Sustainability Services (CCASS): Developing a decarbonisation strategy

Whilst there are an ever-increasing number of companies seeking to reduce their own GHG emissions and set net zero ambitions, the value of considering a decarbonisation strategy doesn’t necessarily hinge on this. In fact, in many cases, the scope 1 and 2 GHG emissions from a company can be a poor indicator of its exposure to climate risk and, indeed, opportunity. Understanding how the physical impacts from a changing climate, as well as the transitional implications of economies shifting to a net zero emissions future, therefore becomes far more critical in piloting a path towards a more sustainable, profitable, future.

TCFD reports are already beginning to demonstrate the degree to which organisations, and the sectors they operate in, could be impacted by a range of climate scenarios. Whilst many market commentators are calling for greater convergence on the types of climate scenarios assessed by companies, there may be a significant advantage for those who tailor climate scenarios that are most meaningful to their organisation’s ability to create value over time.

EY’s decarbonisation approach is designed to help support companies to navigate the different stages of developing and implementing a climate strategy.
Understand the climate risks and opportunities

In order to understand the strategic implications of climate-related risks and opportunities, companies need to:

1. Map the entire value chain, up and downstream, and complete analysis of the organisation’s carbon footprint to identify material exposures.
2. Perform scenario modelling to stress test the business model, and to clarify risks (both physical and transition) and opportunities, as well as quantify the financial consequences.
3. Establish a view of the potential transition and physical risks and opportunities across the value chain and across sectors and geographies. This should include analysis of the current carbon footprint to identify material exposures. The risks should be prioritised considering the likelihood and impact on the organisation, as well as their likely time horizons to inform the latter stages of planning.
4. Consider the organisation’s climate policy environment and its temperature ambition:
   - High ambition: Policy ambition consistent with minimising warming to 1.5°C
   - Paris Ambition (required by TCFD): Policy ambition consistent with minimising warming to 2°C
   - Low Ambition: Business as usual policy ambition resulting in warming of 4°C
5. Determine the scenarios to be modelled. There are multiple transition pathway considerations within different temperature ambitions (for example whether to model a disorderly or an orderly transition) and thought will need to be given to the range of climate events and their potential cross-dependencies. Time periods will need to be selected based on key internal time horizons and aligned with availability of data.

The next stage is to translate the scenarios into representative pathways by conducting the modelling and quantifying the financial risk and opportunity. This assessment should consider aspects such as the impact of different demand curves, frequency of weather events and changes in markets.
Develop and implement a climate strategy

When it comes to developing and implementing a climate change strategy, no two approaches will be the same. How an organisation chooses to execute is dependent on both the strategy itself and the organisation’s processes and structure. However, our approach to supporting organisations through this process considers the following steps:

1. Define the strategy: The climate change strategy should be linked to external drivers, the specific climate change risks and available opportunities from stage 1. An organisation should set the level of ambition, whether they wish to be in a position of compliance or whether they wish to capture the full value add and be an architect of future markets creating products and services with positive climate change outcomes.

2. Identify carbon reduction targets: The identification of carbon reduction targets can be seen as the quantification of the ambition established in the strategy. It is expected by investors and ESG ratings agencies as well as the TCFD. Targets should be considered in both breadth and depth. Breadth as to whether targets will cover emissions from own operations to scope 3 targets that cover the value chain, and depth as to whether absolute reduction targets will be made to carbon-negative targets. Frameworks such as Science Based Targets Initiative (SBTI) should be considered.

3. Identify and assess strategic options: To execute reduction targets, mitigate risks and capitalise on climate-related opportunities, an organisation should map its strategic options between level of impact and the level of effort in order to prioritise projects.

4. Implementation: The final stage is determining what needs to be done to implement the decarbonisation journey by executing the strategic initiatives, managing work streams and monitoring the results against the desired outcomes.

It is important to remember that in addition to creating risks for organisations, climate change can also create significant opportunities as society transitions to a lower-carbon future. Therefore, developing a robust climate strategy that can be incorporated within the existing business strategy is essential to unlock long-term value creation.
Risk management

Hallmarks of leading practice

• Employ a dynamic risk assessment as an evolution of more traditional risk assessment methodologies. This expands the criteria for assessing risks (beyond impact and likelihood) to take into account future trends, risk interconnectivity and velocity, and the capacity of an entity to adapt and respond to the risks, given speed of potential change etc. Figure 5.1 on the following page provides insight into the way in which Dynamic Risk Assessment might be applied to climate change and other risks.

Climate-related risk processes included top-down and bottom-up risk assessments. A number of companies stated explicitly that they had included climate change on the risk register, and undertaken risk projects to strengthen their understanding of current and future climate-related risks. Examples of mitigation activities included setting an internal price on carbon to encourage low-carbon spending, and encouraging specialists to better understand climate-related risk.

TCFD recommended disclosures

Describe the organisation’s processes for identifying and assessing climate-related risks.

Describe the organisation’s processes for managing climate-related risks.

Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation’s overall risk management.
### Criteria for ESG-related risks

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<thead>
<tr>
<th>Criteria</th>
<th>Description</th>
<th>Relevance for ESG-related risks</th>
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<tbody>
<tr>
<td>Adaptability</td>
<td>The capacity of an entity to adapt and respond to risks</td>
<td>A risk may be significant and unpredictable; however, an organisation can build in adaptability mechanisms to respond to or absorb the risk. For example, in the 1980s, Shell diversified its portfolio and used scenario planning to prepare and adapt to potential oil price fluctuations that were generally considered unforeseeable.</td>
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<tr>
<td>Complexity</td>
<td>The scope and nature of a risk to the entity’s success</td>
<td>Many ESG-related risks are interrelated, global, industry-wide and constantly changing. For example, health care companies are aware of the complex relationship between climate change and health. Climate change impacts may lead to potential disruptions to operations, whilst also leading to health impacts on individuals (increasing the demand for health care services).</td>
</tr>
<tr>
<td>Velocity</td>
<td>The speed at which risk impacts an entity</td>
<td>ESG-related risks are often emerging and unforeseen until swift events result in extreme consequences. Climate change impacts often manifest in the form of more extreme or frequent occurrences of known events, such as droughts and floods, and are best understood by studying longer temporal horizons than are usually associated with typical risk management.</td>
</tr>
<tr>
<td>Persistence</td>
<td>How long a risk impacts an entity</td>
<td>Risk severity should consider the extent to which the impact will be an acute, one-time impact (e.g., cyclones, hurricanes or earthquakes) versus a chronic issue that will cause ongoing impacts (e.g., sustained higher temperatures or droughts).</td>
</tr>
<tr>
<td>Recovery</td>
<td>The capacity of an entity to return to tolerance</td>
<td>Consider how quickly the business would recover if a risk occurred today. For some ESG issues, impacts are irreversible. For example, in the food, beverage and agriculture sector, the impacts of climate change have the potential to alter growing conditions and seasons, increase pests and disease, and decrease crop yield.</td>
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**Hallmarks of leading disclosure**

- Reflect the impact of climate risk within the financial statements, such as in relation to forward-looking assumptions and judgments applied (see Section 7 below).
- Link each risk to a specific business area/risk owner.
- Bring out the interconnectivity between climate change and other principal risks.

**Integration across the ARA**

- Discuss the impacts of climate change in the risk management section (*M&G*, see Figure 5.3; *Royal London Asset Management*, see Figure 5.4).
- Companies in high-risk industries should be explicit on how viability scenarios have considered the impact of climate change (*Rolls-Royce Holdings plc*, see Figure 5.2). In our work we identified some companies that referenced climate change in their scenarios even though they do not identify climate change as a principal or emerging risk; in such cases we recommend explaining the reason for this.
Figure 5.2
Rolls-Royce Holdings plc 2020 ARA (pp55 and 136) references the impact of climate change at a high level within its viability statement.

Viability
The viability assessment considers solvency and liquidity over a longer period than the going concern assessment. Our downside scenario uses the same assumptions as the going concern scenario and in 2013 to 2025 assumes a slower recovery back to 2010 level than assumed in our base-case. The analysis excludes proceeds from disposals and additional funding which have not yet been agreed but, if and when realised, will increase liquidity at least £2bn.

Consistent with previous years, we have assessed our viability over a five-year period which is in line with our five-year annual target setting process. We continue to believe that this is the most appropriate time period to consider as, inevitably, the degree of certainty reduces over any longer period.

In making the assessment, we have used the same base case and severe but plausible downside scenarios and existing committed borrowing facilities as set out in the going concern assessment, with the analysis extended over five years. We have combined additional severe but plausible scenarios that estimate the potential impact of additional principal risks arising over the assessment period, for example: the loss of a key element of the supply chain, a compliance breach, a trade war between major trading blocs, failure to deliver the expected benefits from our restructuring activities, the impact of climate change or a significant product safety event. This impact on viability of some of the risks modelled, such as Business Continuity and Political risk, has reduced compared to last year due to falling CE volumes and lower EFNs.

The assessment takes into account UK tax laws that, in broad terms, restrict the offset of the carried forward tax losses to 50% of current year profits. Based on this assessment, the Group has recognised a deferred tax asset of £80m relating to losses and £165m relating to ACT. This reflects the conclusions that:
- It is probable that the business will generate taxable income and tax liabilities in the future against which these losses and the ACT can be utilised.
- Based on current forecasts and using various scenarios these losses and the ACT will be utilised in full within the expected worldwide engine programme lifecycles.
- The Group has not recognised any deferred tax assets in respect of 2020 UK losses and de-recognised £32m of the deferred tax asset on the balance sheet at 31 December 2019. Of the total charge, £29m is underwriting the balance of £276m non-underwriting.
- This is based on management’s assumptions relating to the amounts and timing of future taxable profits and takes into account the impact of COVID-19 and climate change on existing worldwide engine programmes.

Changes in future profits will impact the recoverability of the deferred tax assets and as explained in note 1, the key assumptions impact contract margins. A 5% change in contract margins over the remaining life of the programmes, against which the recovery of the tax losses and ACT is assessed, would result in a variance of around £100m in the related deferred tax balances recorded on the balance sheet, assuming a 19% tax rate and the 50% loss offset restriction mentioned above.

The assessment also considered the potential impact of climate change on profit forecasts, including additional taxes and levies that could arise and changes in consumer behaviour which could result in a reduction in shop visits (given by EFNs, which are influenced by a number of factors including climate change). A 5% reduction in shop visits over the remaining life of the programmes would result in a variance of around £150m in the related deferred tax balances.

Figure 5.3
M&G 2020 ARA (p67) discusses climate risk management as part of the regular Risk Management Framework.

Figure 1
Towards TCFD compliance
32

Our expected ability to stay within the asset allocation assessed during the annual business planning process, with the actual position monitored and managed regularly throughout the year.

We also have risk appetite statements and accompanying financial limits in place for significant individual risks, including a comprehensive Group Approved Limits Framework. In combination, the individual appetite statements and limits are set such that we operate in line with the approved aggregate risk appetite statements even when the individual limits are fully utilised.

We use prescribed indicators to inform whether a risk may move out of appetite and, together with limited utilisation, this is a core element of risk reporting to Board and Executive Risk Committees with appropriate management actions.

Climate risks
Climate change risk is currently managed through the M&G plc Risk Management Framework, with risk oversight and assurance delivered in accordance with the three lines of defence model. In addition an M&G plc ESG Risk Management Framework is being established to provide additional focus on the risk management activities required for ESG and climate change risk. The management and monitoring of ESG risk, including climate change risk, will align to our ESG risk appetite statement(s), which are currently under development, to support our ESG-related commitments and targets, with the aspiration of meeting stakeholder expectations.

We are also building our risk management controls to cater for the diverse needs of a range of stakeholders groups, geographical territories and compliance requirements to identify the most effective data, policy, process and reporting approach for the future.

Sustainability risks, along with other risks types, are identified, assessed and managed under the M&G plc Risk Management Framework and specific emphasis is on the management of this risk will be outlined within the M&G plc ESG Risk Management Framework, which is currently under development. Consideration of ESG Risk is built into the decision-making processes and a requirement of key strategic board risk assessment papers. Climate change risk is being integrated into our scenario analysis process with both top-down and bottom-up consideration over a range of time horizons.

Climate change is significant to our corporate operations and the large portfolios of assets we manage on our own behalf and for our clients, making ESG risks critical to our business model and priorities.

We combine a range of approaches to help us to identify, understand and articulate climate risks, including academic research, industry shared learning, scoring tools and relevant data sources, and best practice guides.

Scenario analysis is an important tool in assessing the impacts of these risks over a range of time horizons and potential climate pathways. M&G has undertaken climate scenario analysis with further work underway to develop and enhance our approach to provide additional insights into the climate risk faced by the business both now and in the future.
Figure 5.4
Royal London Asset Management TCFD Report 2020 ARA (pp24-25) explains the integration of climate change into the risk management framework.

Risk management

RLAM’s risk management framework consists of a cohesive set of components designed to sustain and uphold high standards. This helps to ensure that the firm’s performance and achievement of its objectives are not undermined by unexpected events.

As part of its risk management framework, RLAM defines risk strategy, risk appetite and policies which set out the objectives, limits and tolerances within which the board expects the business to operate. Such an approach provides assurance that the risks to which RLAM may be exposed are being appropriately identified and managed within its risk appetite, whilst impact is being minimised.

Climate risk in RLAM

As an asset manager, RLAM has the fiduciary responsibility to protect the assets managed on behalf of our clients and mitigate the impact that climate change can have on these holdings. Therefore, during the course of 2020, RLAM undertook a number of initiatives to integrate climate change into its risk management framework and ensure that its climate change strategy is reflected through different components of this framework to enable informed decision-making at various levels.

The risk management framework consists of a set of tools and procedures which allows RLAM to identify, manage and mitigate risks the firm is exposed to. In particular, climate change risk has been recognised in the risk taxonomy, risk and control self-assessment process and throughout risk governance. Climate risk is identified as an emerging risk within RLAM’s risk register, in recognition of the long-term nature of some of its impacts. Additionally, climate-related risks are captured in our risk management system and are linked to reputational, operational and regulatory risks. See figure 10.

Emerging risks arise from the external environment as a result of technological, economic, environmental and/or geopolitical changes. We manage emerging risks with the aim of protecting our business and achieving its strategy. See figure 11.

Through its integration in RLAM’s risk management model, the climate change risk is captured and reviewed by our three lines of defence operating model. See figure 12.

The structure for identifying, managing and reviewing RLAM’s climate risks is displayed. See figure 13.
View from EY Enterprise Risk Management: Integrating climate-related risk

EY can help companies strengthen their consideration of climate-related risks and their impact (per TCFD Strategy pillar), as well as integrating climate-related risks into the wider risk management processes (per TCFD Risk Management pillar).

Based on our work to date, what is clear is that the challenges organisations face in integrating their climate-related risks depend on the maturity of the existing risk approach. Where the risk approach is dynamic and flexible — capitalising on risk automation and the right risk behaviours — incorporating a ‘new/emerging’ risk is more straightforward than for others who are still operating a more traditional, manual based approach that is heavily focused on following a fixed, annual process.

Irrespective of maturity, climate-related risk needs to be considered across all aspects of the risk approach. As a minimum, when working with companies we recommend prioritising the following areas:

1. **Risk articulation:** What are the risks that are relevant to the organisation and may affect the achievement of its objectives — both from a transition and physical perspective — and who should be involved in helping to define these? Is there upside opportunity to exploit as well as downside risk to manage?
   - What time horizon should these be considered over, and how does this align with existing risk time frames?
   - Do these risks give rise to a standalone principal risk, or are they drivers or constituents of other risks? How does it make most sense to define these in terms of the organisation's strategy, objectives and resources to address these risks?
   - How do these risks fit with the organisation's risk universe/taxonomy and existing risk profile?

2. **Risk assessment:** Has the organisation expressed its appetite for managing climate-related risks within its risk appetite statements, and do the current risk scoring criteria allow for a proper consideration of this? If not, how should the organisation's appetite for these risks be articulated?
   - Should the organisation establish a separate risk appetite for climate risk or include this with an existing category, e.g., ESG, social licence to operate?
   - If the risk is believed to be emerging for the organisation, are traditional methods of assessing risk (e.g., likelihood and impact) appropriate or is there a need to think about different ways to measure the risk, velocity, management preparedness?

3. **Risk response:** What responses to these risks are proportionate in the context of the organisation?
   - How is the organisation's appetite for addressing these risks reflected across its control framework e.g., considered in policies, processes, training, etc.?
   - Have potential climate-related scenarios been analysed and tested to ensure an objective and proportionate response has been applied to the risks?
4 Risk oversight and reporting: What governance and monitoring mechanisms need to be in place to help ensure climate-related risk information is available at the right time and in the right format for the right people to make decisions?

a. Who should own climate risk within the organisation?

b. How are roles and responsibilities for these risks defined, communicated and monitored across the three lines of defence?

c. How are these risks incorporated within the risk reporting process? Is data available in real time? Are predictive indicators (KRIs) used to warn of increasing exposure?

5 Risk culture and behaviours: How has the role of behaviour and culture been considered in the management of climate-related risks?

a. Have risk behaviours been defined and assessed to target communications, education and other interventions to drive the right support and actions of different internal stakeholder groups?

b. How does the management of climate-related risk fit with the organisational purpose and values? How does it impact decisions around its interactions with third parties and the broader value chain?

As with any other type of risk, what we have observed is that effectively integrating climate-related risk within the existing risk approach will enable better engagement with a range of stakeholders. In addition, integration helps to ensure quality risk conversations and appropriate responses based on the materiality of these risks in the context of the existing risk profile.
As noted in a recent benchmark analysis issued by Climate Action 100+, the world’s largest investor engagement initiative on climate change, 52% of the world’s largest emitters have made a net zero commitment of some type but more work is needed on interim targets and the strategy for decarbonisation.\footnote{Climate Action 100+ Net Zero Company Benchmark, Climate Action 100+, March 2021.} We found that a number of companies within our sample have set goals such as ‘net zero’, but it is not always clear how progress towards these will be measured, monitored or assured. From our engagement it also appears that reporters are not always clear on the difference between the concepts of net zero, science-based targets and carbon neutrality.
Hallmarks of leading practice

- Set ambitious targets, for example, to achieve net zero by 2050 or sooner.
- Provide an overarching roadmap for achieving net zero, providing shorter-term interim targets to support the longer-term goals.
- Establish and monitor metrics relating to climate-related risks and opportunities, e.g., percentage of ‘green revenue’. Climate-related KPIs should be established based on what is most relevant in the context of the resilience of the business model to climate-related risks. As an example, for a property company this might be percentage value of portfolio exposed to a 10-20% risk of inland, coastal and flash flooding within a certain period.
- Use a science-based approach to set your targets\(^ {17} \) to reduce emissions (Senior, see Figure 6.1).
- Start measuring scope 3 emissions and monitor their alignment with the ambition that has been set (Anglo American, see Figure 6.3).
- Participate in external benchmarking of performance to help track and assess progress, such as using reporting to CDP.
- Develop appropriate control systems for climate-related disclosures; as a first step focus on improving internal controls over the data collection, before obtaining third-party assurance. Diageo 2020 ARA (p184) obtained independent limited assurance of selected sustainability and responsibility performance data for its 2020 ARA. Intertek 2020 ARA (p37) obtained independent assurance of its environmental performance.
- Align executive pay to longer time horizons and, where relevant, incorporate assured climate-related metrics (Croda, see Figure 6.4).

Examples of leading disclosure

- Explain targets clearly, e.g., what ‘net zero’ means, with reference to specific timeframes, base year, milestones etc. Provide a description of methodologies used to calculate targets and measures, including their boundaries.
- Provide commentary in respect of the Streamlined Energy and Carbon Reporting (SECR) disclosures that is both transparent and meaningful. NatWest 2020 ARA (p28) provides a useful table overview to highlight the key information in relation to SECR such as intensity ratio and scope 3 emissions.
- Disclose scope 3 emissions to demonstrate how well you understand the climate exposure of your value chain.
- Disclose decarbonisation pathways, especially given the increased scrutiny on how well companies prepare and contribute to decarbonisation solutions (Glencore, see Figure 6.5).

A number of global groups are working to consider what credible net zero plans should look like, including the Science Based Targets initiative (we consider setting science-based targets to be leading practice) as well as the Climate Action 100+ investor group.

Having consensus on an agreed definition of net zero will help to address “greenwashing” and controversy over so-called “avoided-emissions” and the use of carbon offsets highlight. Carbon offsets should not be confused with carbon removal. Similarly, so-called avoided emissions do not count towards science-based targets.

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\(^{17}\) Science-based targets show companies how much and how quickly they need to reduce their greenhouse gas (GHG) emissions to prevent the worst effects of climate change. For more detail, see The Science Based Targets initiative.
"Reporting should not be used as a fig leaf for inaction. Investors are concerned that companies are hiding behind disclosures without truly addressing climate change. We are forward-looking, which is why a company’s trajectory, its intention and actions for the future are very important to us.

Companies should set stretch targets backed by interim goals and clear plans. Targets should also be Paris aligned and signed off by the Science Based Targets initiative.

Companies sometimes worry that they will be automatically “punished” for not meeting a climate target in the near-term. As long as the reasons are clearly explained, credible actions to rectify the situation have been identified and we can understand the future direction of travel of the business, that will not be the route we take.

Lloyd McAllister, Responsible Investment Analyst, Newton Investment Management

Integration across the ARA

- If the ARA contains an upfront ‘performance highlights’ section, consider including a climate-related metric.
- Link climate-related metrics to any key risk indicators (KRI-metrics of risk exposure) associated with physical and transition risks.
- Consider whether any climate-related metrics should be considered as key performance indicators (KPIs) (Barclays, see Figure 6.2).
- Demonstrate a cohesive narrative across the strategic report and the directors’ remuneration report.

"There are various interesting forward-looking indicators in development (e.g. warming potential) that may help with the assessment of portfolio alignment (noting that portfolio alignment per se does not guarantee real-world decarbonisation.). These are however in their infancy and the results can be very divergent. Which is why companies in their reporting need to establish the methodologies, assumptions and limitations related to key climate metrics and these need to be clearly disclosed. It is impossible to contextualise information without this.

Carlota Garcia-Manas, MSc
Senior Responsible Investment Analyst at RLAM"
**Figure 6.1**

Senior 2020 ARA (p15) has its emissions reduction targets independently verified.

Senior takes leadership position in verifying our carbon reduction targets

In 2020 we were successful in having our carbon emission reduction targets verified by the Science Based Target Initiative ("SBTi"). The SBTi is a partnership between CDP, the United Nations Global Compact ("UNGC"), World Resources Institute ("WRI") and the World Wide Fund for Nature ("WWF"). The SBTi calls to action is one of the We Mean Business Coalition commitments.

Senior is the first company in the global Aerospace & Defence sector to have its emissions reduction targets independently verified and approved by the SBTi. The targets covering GHG emissions from Senior’s operations are consistent with reductions required to limiting climate warming to 1.5°C.

The Paris Agreement’s long-term temperature goal is to keep the increase in global average temperature to well below 2°C above pre-industrial levels, and to pursue efforts to limit the increase to 1.5°C, recognising that this would substantially reduce the risks and impacts of climate change.

SBTi have approved the following targets:

- Senior commits to reduce its absolute Scope 1 and 2 GHG emissions by 30% by 2025 compared to a 2018 base year.
- For Scope 3 GHG emissions, Senior also commits that 30% of its suppliers by spend, covering purchased goods and services and capital goods, will have science-based targets by 2025.

In the SBTi’s target assessment report, Senior’s Scope 1 and 2 targets were considered ambitious as they track to a 1.5°C global temperature increase.

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**Figure 6.2**

Barclays 2020 ARA (pp22-23) provides two KPIs relating to climate-related considerations (i.e., operational carbon emissions as well as social and environmental financing).

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**Figure 6.3**

Anglo American 2020 ARA (p37) assesses scope 3 emissions across its entire value chain once every two years.

In 2019, we undertook a Group-wide Scope 3 emissions assessment, covering the period 1 January 2018 to 31 December 2018. The emissions from this period were 225 Mt CO2e. We plan to carry out this detailed assessment every two years.

Anglo American 2020 Sustainability Report (p40).

Scope 3

We recognise that our Scope 3 emissions are always another organisation’s Scope 1 and 2 emissions. In other words, they are not directly within our control and are complex to measure.

In 2020, we published a detailed inventory of our 2018 Scope 3 emissions, which provides clarity across the 15 categories into which Scope 3 is divided, covering the full value chain. This provides a firm foundation for future action.
Figure 6.4
Croda 2020 ARA (pp32, 39 and 90) discloses its commitment to have its SBTs validated.
Emissions performance is assured and considered as a KPI, and linked to executive remuneration.

Tackling the climate crisis is our biggest challenge, but, through decarbonisation, innovation and customer collaboration, it also offers us our greatest opportunities.

Reducing emissions

Milestones
- 26% reduction in absolute scope 1 and scope 2 emissions at the end of 2024
- All Croda locations to have a decarbonisation roadmap by the end of 2022

We are committed to reducing emissions in line with the science required to limit global warming to 1.5°C above pre-industrial levels, and are signed up to the UN Global Compact’s Business Ambition for 1.5°C. Early in 2021 we will have our Science Based Targets validated — to be on track to achieve our targets, our manufacturing sites need to reduce emissions by 42% by 2030 (using 2018 as the baseline).

In 2020, manufacturing sites representing 90% of our total emissions developed decarbonisation roadmaps to 2030. This involved understanding current energy requirements, identifying opportunities to reduce and re-use energy, as well as exploring the feasibility of switching to renewable sources. These roadmaps have been codified and the global position quantified from both financial and carbon reduction impact perspectives.

This outstanding work gives us confidence that our Climate Positive commitment is achievable.

2020 also saw us confirm and start to implement an internal carbon price of €30/tonne CO₂ for all capital expenditure applications. We believe this will continue to drive the right investment decisions for us to meet the challenging targets we have set.

The majority of our emissions lie within our supply chain, embedded in our raw materials. To reduce these emissions, we will also roll out a scope 3 Science Based Target during 2021. Collaboration, engagement and encouraging suppliers to set their own emissions reduction targets will be key to us making progress. As many of our key customers have also committed to Science Based Targets, our Climate Positive commitments will support them in achieving their own scope 3 reductions, with the cradle-to-gate carbon footprint of our products significantly reducing over this critical decade for climate action.

Shu Ying Tan
Graduate Trainee, Croda Singapore

“|
It is an exciting and valuable experience to be involved in creating the roadmap, where we can improve current processes and explore novel technologies which may very soon become the norm for us.”

Shu Ying Tan
Graduate Trainee, Croda Singapore

Figure 6.4

To meet our Science Based Targets, reducing emissions in line with global warming to no more than 1.5°C above pre-industrial levels.

Scope 1 & 2 emissions intensity (TeCO₂e/Em)

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<td>266</td>
<td>250</td>
<td>238</td>
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<td>219</td>
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</table>

Scope 1 and 2 emissions intensity

Our chosen measure of GHG emissions intensity divides our GHG emissions (market-based scope 1 & 2 emissions divided by value added) as a measure of our business activity. Our 2015 baseline year, along with 2019, were calculated using location-based scope 2 emissions as a proxy. Since 2019, our GHG emissions intensity has improved by 33%, illustrating how we are decoupling growth from our environmental impact.

Our scope 1, 2 and 3 GHG emissions are verified by Acius.

Towards TCFD compliance

Scope 1 and 2 emissions intensity

- NPP (16%): NPP needs to grow at twice the rate of non-NPP, subject to overall positive Group profit growth and a minimum average of 2% NPP growth per year, with payments being made on a sliding scale up to 5% growth per year.
- Climate Positive (15%): a reduction target specifically aimed at Scope 1 and 2 emissions and aligned with our external commitment to achieve a Science Based Target (SBT) in line with 1.5°C pathway. Over the three-year PSA performance period the target is +1.2% reduction relative to 2020 and is measured against the ‘best in class’ median of Scope 1 and 2 emissions.
- Sustainability metrics (30%): includes a number of non-financial indicators such as sustainability metrics.

Our performance

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<td>274</td>
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<tr>
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<td>238</td>
</tr>
</tbody>
</table>

- Median: 266
- Upper quartile: 238

- Performance measure (excluding)
  - Profit before depreciation
  - Employee costs at 2019 constant currency.

- Performance measure (excluding)
  - Profit before depreciation
  - Employee costs at 2020 constant currency.

- Performance measure (excluding)
  - Profit before depreciation
  - Employee costs at 2019 constant currency.

- Performance measure (excluding)
  - Profit before depreciation
  - Employee costs at 2020 constant currency.
Figure 6.5
Glencore 2020 ARA (pp17 and 19) illustrates its pathway to achieve its medium-term target and long-term ambition.

In 2020, we conducted assessments of physical and regulatory risks to our operations against the Current Pathway and Rapid Transition scenarios. Our Climate Report 2020: Pathway to net zero details the risks and opportunities identified across the business, as well as the mitigating actions.

Our work programme for 2021 includes:

- Validating the 2019 baseline for Scope 3 emissions
- Progressing commodity departments’ marginal abatement cost curves to support our assessment and implementation for CO₂ emission reduction projects

Illustrative emissions pathway to net zero
(million tonnes CO₂)

[Diagram showing emissions pathway to net zero]

2019 Scope 1+2+3
Asset Depletion Scope 1+2
Net Assets Depletion Scope 3
Decarbonise Scope 1+2
2035 Scope 1+2+3
Energy Efficiency + Fuel Switch
Asset Investments Scope 1+2+3
Offsets and efficiencies
Coal Depletion Scope 1+2+3
2050 Net Zero
Based on our review, the disclosure of climate change in the financial statements lags behind narrative reporting and is often not reflective of the quantified information that is already being provided within CDP disclosures.

Even where disclosures are not required by a standard, we encourage companies to disclose financial implications arising from climate-related risks to address investor expectations. These may include but are not limited to the following:

- Asset impairment, including goodwill (IAS 36)
- Changes in the useful life of assets (IAS 16; IAS 38)
- Changes in the fair valuation of assets (IFRS 13)
- Effects on impairment calculations because of increased costs or reduced demand (IAS 36)
- Changes in provisions for onerous contracts because of increased costs or reduced demand (IAS 37)
- Changes in provisions and contingent liabilities arising from fines and penalties (IAS 37)
- Changes in expected credit losses for loans and other financial assets (IFRS 7)
For further guidance in this area, refer to the International Accounting Standards Board’s (IASB) paper on the effects of climate-related matters on financial statements (Nov 2020), which is also referenced in EY’s IFRS Developments Issue 177: Effects of climate-related matters on financial statements publication. See also The Climate Disclosure Standards Board’s publication for considerations in relation to integrating climate-related matters into financial reporting, which builds on IASB’s position on accounting for climate.

We found only a few companies that reference climate-related matters in relation to the financial statements, most of these in the extractive industry. For example, Shell 2020 ARA (p150) discloses the AC’s consideration on the potential impacts of climate change in respect of impairment and taxation. For further examples, see Figures 7.2 and 7.3.

Anglo American 2020 ARA (pp117, 169, 170 and 181) references the AC’s consideration of climate change in the context of asset impairment and the company’s approach to assurance over sustainability KPIs.

**Significant accounting issues considered by the Audit Committee in relation to the Group’s financial statements**

- **Impairment and impairment reversals of assets**
  The value of mining operations is sensitive to a range of characteristics unique to each asset. Management is required to apply judgement in the estimation of Ore Reserves, and price and production forecasts which drive cash flow projections.

Response of the Audit Committee
The Committee exercises oversight over the impairment review process. The Committee assessed the identification of impairment and impairment reversal indicators, the impact of Covid-19 and climate change on commodity price and exchange rate assumptions, the review of changes in the valuation of cash generating units (CGUs) and associated sensitivity analysis, and the appropriateness of disclosures made within the 2020 Integrated Annual Report on key sources of estimation uncertainty. During 2020, the most significant assets considered were the following:

- **New accounting standards and best practice guidance**
  The impact of new accounting standards, and any elections made in their application, involves judgement to ensure their adoption is managed appropriately.

  The Committee reviewed management’s impact assessment of new standards and amendments which came into effect on 1 January 2020, but were not considered to have a material impact on the Group. The Committee also reviewed the steps taken by management to ensure that the Group is able to comply with the JSE reporting requirements that came into effect for reporting periods ending on 31 December 2020.

  The Committee considered the Group’s approach to sustainability KPI assurance in order to facilitate best practice climate change disclosures. The Committee also received updates on government consultations regarding UK Corporate Reform which are anticipated to bring wide-ranging changes to the corporate regulatory landscape.

**Accounting Judgements**

Environmental restoration and decommissioning provisions
The recognition and measurement of environmental restoration and decommissioning provisions requires judgement and is based on assumptions and estimates, including the required closure and rehabilitation costs, the timing of future cash flows, and the discount rates applied. The Group considers that no reasonably possible change to a single assumption would have a material impact on the provisions; however, a combination of changes in multiple assumptions may.

The Group considers the impact of climate change on environmental restoration and decommissioning provisions, specifically the timing of future cash flows, and has concluded that it does not currently represent a key source of estimation uncertainty. Changes to legislation, including in relation to climate change, are factored into the provisions when the legislation becomes enacted.

**Impairment and impairment reversals of assets**

*Critical accounting judgements*

The Group assesses at each reporting date whether there are any indicators that its assets and cash generating units (CGUs) may be impaired. Operating and economic assumptions which could affect the valuation of assets, using discounted cash flows, including those that could be imported by the Group’s current and emerging principal risks such as climate change, are updated regularly as part of the Group’s planning and forecasting processes. Judgement is therefore required to determine whether the updates represent significant changes in the service potential of an asset, or CGU, and are therefore indicators of impairment or impairment reversals. The judgement also takes into account the Group’s long-term economic forecasts, market consensus and sensitivity analysis of the discounted cash flow models used to value the Group’s assets.

- **Discount rates**
  Cash flow projections used in fair value less costs of disposal impairment models are discounted based on real post-tax discount rates, assessed annually. Adjustments to the rates are made for any risks that are not reflected in the underlying cash flows, including the risk profile of the individual asset and country risk. A real discount rate of 7.5% has been used in the majority of the Group’s fair value less costs of disposal models which are prepared in US dollars (2019: 7.0% used in all valuation models). A real discount rate of 9.5% has been used for South African thermal coal assets (for which the valuation model has been prepared in South African rand) to reflect specific risk factors including country risk, climate change risks and other asset specific risks.

- **Climate change**
  Climate change may have a number of impacts for the Group including the risks and opportunities relating to the demand for the Group’s commodities as a result of the transition to a low carbon economy and physical risks caused by climate change. For extracted commodities, the Group has incorporated carbon pricing, where material, in its projected cash flows. Short term carbon prices are incorporated based on currently enacted legislation, and where applicable longer term carbon prices are based on latest internal views, formed with reference to external forecasts. Separate carbon prices are used for developed and developing economies. Carbon costs are based on a carbon price per tonne of CO₂e multiplied by estimated Scope 1 and 2 emissions. The cost and benefits of achieving the Group’s emissions reduction strategy is included when the Group has a high degree of confidence that a project will achieve a reduction, which typically aligns with the related capital project being internally approved. The Group’s commodity price and other key assumptions represent management’s best estimate and do not reflect a specific climate-related scenario.
Figure 7.3
Rolls-Royce Holdings plc 2020 ARA (pp114, 118 and 179) references climate-related considerations in respect of its financial statements under key areas of judgment and sources of estimation uncertainty.

Key areas of judgement and sources of estimation uncertainty
The carrying value of the investment in subsidiary undertakings is reviewed for impairment on an annual basis. The recoverable amount is determined based on value in use which requires the determination of appropriate assumptions (which are sources of estimation uncertainty) in relation to the cash flow forecasts (including the impact of climate change), the long-term growth rate to be applied and the risk-adjusted discount rate used to discount the estimated cash flows to present value.

Estimation uncertainty arises due to changing economic and market factors, most particularly as a result of the COVID-19 pandemic. The recoverable amount of the investments in Rolls-Royce Group Limited and Rolls-Royce plc of £4.7bn has been assessed for impairment based on a value in use calculation using cash flow projections from the Group’s latest forecasts which have regard to the current market and the Group’s views on the future achievable growth. Discount rates used reflect current market assessments of the time value of money and the rate of return a market participant would require. The rate used to discount the forecast cash flows reflect the individual businesses in the Group and is 9% post-tax. The Directors have determined that no impairment charge is required. An increase in the rate from 9% to 12% would cause the carrying amount of the Company’s investment to equal its recoverable amount. This sensitivity does not assign value to the new programmes that the Company expects to bring to market as part of its sustainability initiatives.

Climate change
In preparing the Consolidated Financial Statements management has considered the impact of climate change, particularly in the context of the disclosures included in the Strategic Report this year and the stated net zero targets. These considerations did not have a material impact on the financial reporting judgements and estimates, consistent with the assessment that climate change is not expected to have a significant impact on the Group’s going concern assessment to September 2022 nor the viability of the Group over the next five years. The following specific points were considered:
- The Group continues to invest in new technologies including hybrid electric solutions in Power Systems, continued development of the more efficient UltraFan aero engine, testing of sustainable aviation fuels, SMRs and hybrid and fully electric propulsion.
- The Group continues to invest in onshore renewable energy generation solutions for our facilities and investment is included in our five year forecasts to enable us to meet our 2030 target for zero greenhouse gas emissions (scope 1 and 2) from our operations and facilities.
- Management has considered the impact of climate change on a number of key estimates within the financial statements, including:
  - the estimates of future cash flows used in impairment assessments of the carrying value of non-current assets (such as programme intangible assets and goodwill) (see note 9);
  - the estimates of future profitability used in our assessment of the recoverability of deferred tax assets in the UK (see note 5); and
  - the long-term contract accounting assumptions, such as the level of EFHs assumed, which consider our future expectations of consumer and airline customer behaviour (see note 16).

Key estimate – Estimates necessary to assess whether it is probable that sufficient suitable taxable profits will arise in the UK to utilise the deferred tax assets
Deferred tax assets are recognised to the extent it is probable that future taxable profits will be available, against which the deductible temporary difference can be utilised, based on management’s assumptions relating to the quantum of future taxable profits. Future taxable profits require significant estimates to be made, including the pattern of future maintenance activity and the costs to be incurred; lifecycle cost improvements over the term of the contracts; and escalation of revenue and costs. The estimates take account of the inherent uncertainties, constraining the expected level of profit as appropriate. Changes in these estimates will affect future profits and therefore the recoverability of the deferred tax assets. Further details can be found in note 5.

A 5% change in margin in the main Civil Aerospace widebody programmes or a 5% change in the number of shop visits (driven by EFHs which are influenced by a number of factors including climate change) over the remaining life of the programmes, would result in an increase/decrease in the deferred tax asset by around £100m.
Environmental considerations are not limited to climate change or carbon emissions. Whilst this is the focus of TCFD, companies need to address wider factors material to their business, even where reporting on these is not yet mandated. These include, but are not limited to, natural resources (including water, biodiversity, land use and forestry, and marine resources), as well as pollution, waste and circular economy (see Figure 8.1).
If climate-change-related risk is anything to judge by, regulators will continue to look to the industry (investors and companies), whilst developing sustainability-related legislation. One area worth paying special attention to is biodiversity:

- As Sir Partha Dasgupta notes in the Government’s review on biodiversity\(^\text{20}\), it is no longer possible to exclude nature from our economic analysis.
- As many as 55% of respondents who took part in the Credit Suisse and Responsible Investor survey believe biodiversity needs to be addressed in the next 24 months.\(^\text{21}\)
- BlackRock states it may vote against the re-election of directors if companies had not effectively managed, overseen or disclosed natural capital-related risks (i.e. the supply of the world’s natural resources). It may also vote for shareholder proposals that highlight material natural capital risks.\(^\text{22}\)
- BNP Paribas Asset Management, AXA Investment Managers and Mirova are developing a tool to rate companies according to their impact on biodiversity on a large scale, creating a methodology and database for investors to use in their investment decision-making process.\(^\text{23}\)
- 73 organisations, including financial institutions, private firms and regulating bodies, are working towards the scope of a new Taskforce on Nature-Related Financial Disclosures\(^\text{24}\) (TNFD) to develop an international reporting standard for nature.
- 11 of the top 50 asset managers have published position papers on biodiversity. Most of these papers are from 2020 onwards, signalling an upsurge of interest in this subject by the investment community.\(^\text{25}\)

Companies are already reporting environmental matters beyond climate risk, within ARAs and separate sustainability reporting, and we have included a number of examples of such disclosures. See Figures 8.2 - 8.5.

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21 Unearthing investor action on biodiversity, Credit Suisse and Responsible Investor, January 2021.
22 Investment stewardship commentary, BlackRock, March 2021.
24 For more information about TNFD, visit https://tnfd.info/
25 The playing field – a look at the world’s largest 50 asset managers, SquareWell, February 2021.
Biodiversity

We are acutely aware of the interconnected challenges of climate change and biodiversity loss, and the significant risks these have for the environment, wildlife and humanity as a whole. We recognise our operations inherently pose a risk to biodiversity, as well as to the communities that rely on the environment – directly and indirectly – for their lives and livelihoods. Our aim is to avoid such harm when possible and mitigate it when we cannot avoid it.

Protecting biodiversity, therefore, is an important part of our commitment to communities and our employees, as well as to the environment. We are committed to minimising our risks and impacts to biodiversity through the application of the mitigation hierarchy, with the ambition of achieving no net loss to biodiversity at our assets. ‘No net loss’ means striking a balance between negative impacts on biodiversity and positive outcomes through mitigation.

To that end, we have been engaging with several external programmes to develop both our roadmap for closure and target-setting approach for biodiversity and land. For example, in 2020, we joined the Informal Working Group on the Task Force on Nature-related Financial Disclosures, which will help steer business towards positive outcomes for nature.

This year, to further sharpen our biodiversity management processes, we assessed all of our managed operations using an approach developed in 2019 by experts from the UN Environment Programme World Conservation Monitoring Centre (UNEP-WCMC). Using this methodology – combined with global biodiversity datasets of threatened species and conservation and protected areas – we prioritised our operations based on their biodiversity sensitivity. Twenty-eight managed operations were identified as being within a five kilometre radius of a Protected Area, or with a high priority for biodiversity.

Also in 2020, we assessed the implementation of our biodiversity protection and natural resources management standard across all of our operations. The review indicated that the completion of risk assessments for biodiversity features, development of action plans and monitoring programmes across our operations is tracking well (see figure one). In 2021, we will focus on ensuring all priority sites have their monitoring programme independently reviewed – another key requirement of the standard.

Assurance processes such as these allow us to identify good practices for replication across the business, while also enabling assets receive the right support and expertise to match their level of risk.

Figure one summarises the implementation of key components of the biodiversity protection and natural resources management standard for all managed sites with a focus on the high-priority sites.

### Reducing environmental impact

<table>
<thead>
<tr>
<th>Environmental Impact</th>
<th>Reduction</th>
<th>Proportion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greenhouse gases</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Target: By 2020, CO2 emissions from energy (kg CO2 per tonne of production)</td>
<td>145.92</td>
<td>50.76</td>
</tr>
<tr>
<td>Waste</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Target: By 2020, water abstraction (megalitres per tonne of production)</td>
<td>2.97</td>
<td>1.54</td>
</tr>
<tr>
<td>Water</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Target: By 2020, water consumption (litres per tonne of production)</td>
<td>50%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Figure 8.3

Unilever 2020 ARA (p34) reports on its environmental impact in relation to water, waste and raw materials.
Figure 8.4
Travis Perkins 2020 ARA (p68) discloses targets and progress made in relation to waste reduction and recycling.

Waste objectives
- Set new targets for waste reduction and develop a roadmap.
- Continue to improve processes to ensure that customer expectations are continually met.
- Engage with relevant forums and industry partners to share best practices and collaborate and develop shared solutions at the industry level to move towards a more circular economy.
- Engage with suppliers to reduce the amount of unnecessary packaging entering the Group’s supply chain, in particular single-use plastics.

2020 progress
The Group set itself a new waste target: eliminate all unnecessary single-use packaging by 2025. A further ambition is to divert 100% of waste from landfill.

Eliminating all unnecessary single-use packaging by 2025 is a challenging target and the Group is working closely with key supply chain partners to achieve it. Plans are being developed to meet the requirement of 30% recycled content in plastic packaging by April 2022.

Amid the challenging conditions of 2020, the Group maintained its steadfast recycling operations to help reduce plastic waste and divert waste from landfill. The Group has baled 5,000 tonnes of cardboard, 1,000 tonnes of plastic and 12,000 tonnes of timber, representing 50% of total waste for 2020.

Terms of waste per million yard and car sales

![Waste diverted from landfill](image)

<table>
<thead>
<tr>
<th>Year</th>
<th>2023</th>
<th>2024</th>
<th>2025</th>
<th>2026</th>
<th>2027</th>
</tr>
</thead>
<tbody>
<tr>
<td>Waste diverted from landfill</td>
<td>4%</td>
<td>8%</td>
<td>12%</td>
<td>16%</td>
<td>20%</td>
</tr>
</tbody>
</table>

Case study: Engagement and reducing packaging

As part of the Group’s new Waste & Resources Working Group was formed to bring together subject matter experts from across the Group. This working group has developed a new Waste Policy setting out the Group’s expectations and aspirations, as well as producing a suite of Packaging Advice Sheets to advise on alternative innovative packaging solutions and help reduce single-use plastic.

Figure 8.5
Reckitt Benckiser 2020 ARA (pp24 and 27) discloses environmental metrics beyond climate as part of the business’s KPIs.

Towards TCFD compliance

Financial and non-financial KPIs
We assess operational and strategic progress against key performance indicators, or KPIs. These provide a clear direction as to how much and in what way we should achieve our goals. Importantly, these robust measures are reflected in management targets and are aligned with our growth objectives and our purpose, fight and compass.

The KPIs address financial goals as well as social, environmental and culture aspects. Different business functions manage progress against specific targets in areas such as supply chain performance, customer satisfaction, product innovation and other efficiency measures. These are built into managers’ personal objectives and reviewed regularly.

Integrating environmental, social and governance goals
Our approach embeds non-financial performance into our business while meeting growing consumer and stakeholder expectations. Our integrated model strengthens collaboration between global functions and markets, helping us to deliver financial, environmental and social goals within a strong governance framework. Our executive team reviews progress to continuously drive performance and our impact in society.

Social and environmental impact is increasingly embedded in our product innovation, our ways of working and in our partnerships. Our partnerships reflect the complex networks and ecosystems we are part of. They amplify our collective efforts for greater shared value.

As we close out 2020, we have much progress but know there is more to come. Looking forward, we are increasingly connecting our financial and non-financial goals. Our sustainability ambitions for 2030 aim to reach half the world’s products with our environmental and social targets. We contribute to a cleaner, healthier world and to engage 2 billion people in programmes, partnerships and campaigns that create a positive impact and support the SDGs.

Collective these are both an opportunity for growth and positive societal impact. Our three areas of activity (product-related brands, a healthier planet and a fairer society) are the platforms through which we will deliver this growth and impact. Product innovation will meet the growing needs and expectations of consumers and society. Our actions on climate change build both resilience and opportunity for the future, for example within a low-carbon economy. Our work to enable a fairer, more diverse and inclusive society can strengthen economies, livelihoods and communities while also enabling core values within society. More details of our sustainability ambitions for 2030, and the full details of our targets, approach and performance are available at www.reckitt.com/sustainability.
Closing thoughts

TCFD is challenging but achievable

Companies should not delay getting started. Even for companies which have made a good head start in responding to TCFD, there will need to be further fine tuning/improvements, and an evolution of reporting and underlying processes in the coming years, including in response to the development of recognised standards or guidance. Companies must grasp the nettle, put in the required effort now, and view TCFD implementation both as an iterative journey and a framework that genuinely helps them to manage their exposure to climate-related risk more effectively.

Social impacts of decarbonisation

Finally, to support an inclusive economy, the potential social impacts of tackling climate change must not be ignored. A just transition considers positive and negative impacts on employees and communities in relation to the energy and ecological transition.

Investors are increasingly interested in corporate plans of Just Transition:

- Investment groups Friends Provident Foundation (Friends Provident) and Royal London Asset Management (RLAM) have called on energy utility companies to put in place formal Just Transition strategies, to address the human and economic impact of the transition towards a low-carbon economy by November 2021.
- Prompted by RLAM’s and Friends Provident’s engagement, SSE were the first to announce a formal Just Transition strategy in November 2020.
- Climate Action 100+ may evolve its net zero company benchmark and efforts to better reflect its focus on Just Transition.

Environmental and social externalities have to be tackled in unison — without addressing the social frictions of energy transition we risk the pace of change slowing or worse, we risk a stalemate. Companies and governments may find themselves unable to execute on their plan to decarbonise, if they do not have a plan to address social aspects that arise from it. Which is why we want companies to go beyond TCFD and, either as a standalone report or integrated within other disclosures, explain how they are engaging with stakeholders and working towards a Just Transition.

Carlota Garcia-Manas, MSc
Senior Responsible Investment Analyst at RLAM

26 https://climatejusticealliance.org/just-transition/
27 Press release: Risk of social backlash to low-carbon transition if energy utility companies don’t address its human and economic impact, Royal London, December 2020.
How EY can help

TCFD compliance requires significant work and a fundamental shift in how boards and management consider the impact of the low-carbon transition on strategy, risk, and how they develop measures to monitor performance.

We have developed a tailored approach that has been designed using EY’s leading practice methodology to assess the level of maturity of climate risk disclosures against the TCFD recommendations. We leverage our EY climate disclosure PowerBI to determine how well aligned existing processes and systems are to the TCFD recommendations, how companies compare to their peers and what lessons can be drawn from leading practice.

Climate risk identification and quantification

- Work with your stakeholders to identify key climate-related risks and opportunities.
- Determine the relevant time horizons for climate-related risk and describe the range of related potential futures.
- Conduct scenario analysis to identify how key risks and opportunities may develop over time.
- Advise on the adequacy of climate resilience measures currently in place.

Decarbonisation

- Help companies consider the different external and internal drivers that will influence their low-carbon strategy based on purpose and ambition.
- Develop decarbonisation pathways specific to your business.
- Help demonstrate how a company’s long-term low-carbon position creates value.
- Advise on low-carbon transition and business transformation.

TCFD reporting

- Gap analysis and benchmarking report: Provision of insights through a recommendations report on how to close disclosure gaps against leading practice.
- Detailed priority report and roadmap ahead: Preparing a detailed roadmap of disclosure including key components of Governance, Strategy, Risk Management, Metric and Targets sections to meet stakeholder requirements.
- Full drafting of TCFD: We can develop your TCFD disclosures in full.
- Annual report integration: We can assess how well your TCFD narrative has been integrated within our broader front half narrative and provide recommendations for improvement.

Assurance

- Provide independent assurance of environmental performance.
For support and further information, please contact us.

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Appendix 1:
The Financial Stability Board established the Task Force on Climate-related Financial Disclosures (TCFD) to develop recommendations for more effective climate-related disclosures that could promote more informed investment, credit, and insurance underwriting decisions and, in turn, enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector and the financial system’s exposures to climate-related risks. TCFD recommendations and supporting recommended disclosures.  

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

Appendix 2: FCA’s new Listing Rule for reporting periods beginning on or after 1 January 2021.

An extract of amendments to the Listing Rules sourcebook.\textsuperscript{31}

Italics indicates new text and striking through indicates deleted text, unless otherwise stated.

9.8 Annual financial report

Additional information

9.8.6 R In the case of a listed company incorporated in the United Kingdom, the following additional items must be included in its annual financial report:

(6) a statement as to whether the listed company has:

(b) ...

(iii) the company’s reasons for non-compliance;

(7) a report to the shareholders by the Board which contains the information set out in LR 9.8.8R.; and

(8) a statement setting out:

(a) whether the listed company has included in its annual financial report climate-related financial disclosures consistent with the TCFD Recommendations and Recommended Disclosures;

(b) in cases where the listed company has:

(i) made climate-related financial disclosures consistent with the TCFD Recommendations and Recommended Disclosures, but has included some or all of these disclosures in a document other than the annual financial report:

(A) the recommendations and/or recommended disclosures for which it has included disclosures in that other document;

(B) a description of that document and where it can be found; and

(C) the reasons for including the relevant disclosures in that document and not in the annual financial report;

(ii) not included climate-related financial disclosures consistent with all of the TCFD Recommendations and Recommended Disclosures in either its annual financial report or other document as referred to in (i):

(A) the recommendations and/or recommended disclosures for which it has not included such disclosures;

(B) the reasons for not including such disclosures; and

(C) any steps it is taking or plans to take in order to be able to make those disclosures in the future, and the timeframe within which it expects to be able to make those disclosures; and

(c) where in its annual financial report or (where appropriate) other document the climate-related financial disclosures referred to in (a) can be found.

\textsuperscript{31} PS20/17 Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations, FCA, December 2020.
Appendix: Resources

Below are resources which can help with your consideration of climate-related action and reporting:

1. Climate Action 100+ first-ever net zero company benchmark (March 2021) of the world’s largest corporate emitters.

2. Annual reporting in 2019/20: From intent to action (September 2020), EY’s seventh annual review of over FTSE 350 ARAs, covering a number of key aspects of narrative reporting including climate change.

3. ‘How will ESG performance shape your future?’ (July 2020), EY’s global institutional investor survey.

4. EY’s Climate Risk Disclosure Barometer (2019) covering an overview of climate-related reporting based on a review of over 950 companies globally.

Primarily for financial institutions:

1. Climate change and sustainability: global financial regulators step up the pace (March 2021) sets out six no-regret actions for consideration by financial institutions to address both prudential and conduct implications.

2. TCFD report playbook (September 2020) developed by the Institute of International Finance, with input from EY, to help banks and other financial institutions meet the TCFD recommendations.
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