Navigating TCFD

★ A guiding star report exploring early TCFD reporting in the UK

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Climate risk and the corporate world

Climate change has finally captured the world's attention as an urgent and existential crisis. With estimated financial losses as high as $43 trillion, climate risks have the potential to bring about the collapse of global financial systems, a fact which is increasingly realised by policymakers, investors and CEOs.

With threats ranging from the physical destruction of capital to increased volatility in markets and the potential for stranded assets, the link between climate change and systemic risk is becoming ever clearer.

Prominent industry voices from the financial community have been sounding the alarm for over a decade. The seminal Stern Review, published in 2006, recognised climate change as "the world's biggest market failure". In 2020 and again in 2021, BlackRock's Larry Fink stressed in his yearly letter to CEOs that "climate risk is investment risk". Today, a key priority for investors is to understand how climate risk in their portfolios is being accounted for and – crucially – mitigated.

"The world's biggest market failure"

— Nicholas Stern, author of the Stern Review

"Climate risk is investment risk"

— Larry Fink, Blackrock

$43 trillion

Projected global financial losses due to the climate crisis

Fortifying financial systems

Welcoming TCFD

The COVID-19 pandemic has underscored how impactful risks can be when they occur at a systemic level. As the post-COVID-19 "Build Back Better" pledge by governments around the world becomes reality, the UK – host of this year's G7 and COP26 – has been eager to lead the charge on climate risk regulation.

A key step has been the introduction of mandatory reporting against the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD). The Task Force was convened in 2015 by the Financial Stability Board under the tenure of Mark Carney to identify how the market can begin to better price climate-related risks.

TCFD aims to fortify financial systems against the potential disruptions of physical climate threats and the sweeping policy, legal and technological shifts needed to avert the worst consequences of climate change. As the adage goes, what gets measured gets managed. Disclosure is the name of the game here, and the TCFD process seeks to facilitate efficient allocation of capital towards climate crisis mitigation and adaptation.

What we've learnt from early adopters

Under the new regulation, the first cohort of UK reporters will need to publish in 2022, and the window to prepare for disclosure is closing rapidly. However, many FTSE 350 companies have already embraced the TCFD recommendations, providing insight into early approaches to aligning with the framework.

In this whitepaper, we share our research into emerging TCFD reporting trends to showcase who's doing what and how, and what best practice looks like. We are already embarking on the TCFD journey with many of our clients, and our mission is to support the development of decision-useful TCFD reporting that can be used as a business-material tool in the fight against the climate emergency.

The aim of the TCFD recommendations is to fortify financial systems against the potential disruptions of physical climate threats and the sweeping policy, legal and technological shifts needed to avert the worst consequences of climate change.

TCFD made simple

What is TCFD?

The Task Force on Climate-Related Financial Disclosures is a market-driven initiative with growing political support that provides a framework for clear and consistent climate-related financial disclosures. The four areas and eleven recommendations are designed to help companies understand their financial exposure to climate risk and disclose decision-useful, forward-looking information in a clear and consistent way to investors, lenders, insurers and other stakeholders.

How does TCFD define risk?

TCFD divides climate-related risks into two major categories:

Physical risk:

- Acute: increased severity and occurrences of extreme weather events and hazards such as flooding and cyclones.
- Chronic: longer-term shifts in weather patterns that will have a cumulative impact on financial performance through phenomena like drought and rising sea levels.

Transition risk:

- The related policy, legal, market and technological shifts that will take place in order to support initiatives to decarbonise the economy.

Who needs to comply and what will be required?

The UK government has published a timeframe towards mandatory disclosure across the economy, with most measures coming into effect in 2023. The Financial Conduct Authority (FCA) mandates that premium-listed companies with accounting periods beginning on or after 1 January 2021 must disclose against the recommendations on a "comply or explain" basis.

The cohort of 460 companies within scope should release the first round of mandatory disclosures in 2022. The Department for Business, Energy and Industrial Strategy (BEIS) is currently consulting on TCFD reporting requirements and expects to release the finalised regulation by the end of 2021.

In line with current guidance, companies must disclose:

- a statement of TCFD compliance, contained within the annual report;
- whether the disclosure is aligned to some or all of the eleven recommendations, and an explanation of why, including relevant timelines for full disclosures; and
- where in the annual report or other relevant document(s) the various disclosures can be found.

Mandatory disclosure comes into effect for premium-listed companies in

2022

Four-pillar framework

The TCFD recommends that companies disclose information about their climate-related risks and opportunities against a four-part framework. These are the questions your business should be asking as you start your TCFD journey:

1

Governance
Who is responsible for governing and managing climate-related risks and opportunities? What is their approach?

2

Strategy
What are the actual and potential impacts of climate-related risks and opportunities on your business strategy and future planning?

3

Risk management
How does your company identify, assess and manage climate-related risks?

4

Metrics and targets
What metrics and targets does your company use to assess and manage relevant climate-related risks and opportunities?

Mandatory disclosure comes into effect for AIM-listed companies in
2023

Starting your journey

On the basis of our research, we have identified a series of best practice recommendations for companies reporting for the first time in 2022 and early adopters looking to take their disclosure to the next level.

1 **Start with good governance**
For many companies, board buy-in and education will be the first step towards ensuring that leadership understands the importance of climate risk to the business.

2 **Embrace scenario analysis**
Often seen as the most difficult of the eleven recommendations, scenario analysis is a vital exercise which supports business planning and investment decision making.

3 **Prioritise what's relevant to you**
TCFD is about the impact of climate change on your company, not your company's impact on the climate. A climate materiality assessment can help to determine the unique climate-related risks facing your business.

4 **Leverage existing reporting**
Conduct a gap analysis of existing reporting and initiatives across the business to understand what is already being done to support TCFD needs and outcomes.

5 **Be honest and transparent**
Transparency around the company's progress, clear objectives and prioritising quality over quantity are always preferred to incomplete or overstated disclosure – tell-tale indicators of greenwashing.

6 **Underpin disclosure with action**
TCFD disclosures are only achievable through action, and it will take time to fully implement the recommendations. Put together a roadmap to communicate how you will progress through your TCFD journey.

Our research

About our research

Our duty as sustainability and corporate reporting experts is to facilitate a cleaner, more resilient future through clear communication.

Our objective in undertaking this research is to enhance understanding of the TCFD reporting process in support of our clients and the wider UK corporate landscape.

By evaluating the practices of early adopters, we hope to provide insight into communication challenges and opportunities as the non-financial sector embarks on mandatory reporting next year.

About our methodology

Our research team assessed the FTSE 350 index for TCFD disclosure in the 2020–21 reporting cycle. We excluded the financial services sector, focusing specifically on non-financial sectors where TCFD and climate risk reporting are less well established.

Of the 233 remaining companies, 102 were identified as early adopters. A randomised sample of 32 of these early adopters, representing a cross-section of industries and company sizes, was selected for deeper analysis. Each company was assessed against around 30 criteria. Narrowing our focus to this small set allowed us to drill down into the challenges and opportunities that TCFD reporting offers to new reporters, and to identify early trends and best practice. It is worth noting that this small initial research sample will include some self-selection bias, as early reporters are more likely to share climate-friendly disclosures.

We look forward to monitoring and updating our research as the TCFD framework is implemented more widely across the UK economy.

A telescopic view

This report aims only to share a glance into our research into TCFD. We continuously undertake detailed and industry-specific research, and look forward to monitoring and updating our data as the TCFD framework is implemented more widely across the UK economy and other economies in the G7 and beyond.

102
early adopters

32
cross-sectional sample

30
criteria for assessment

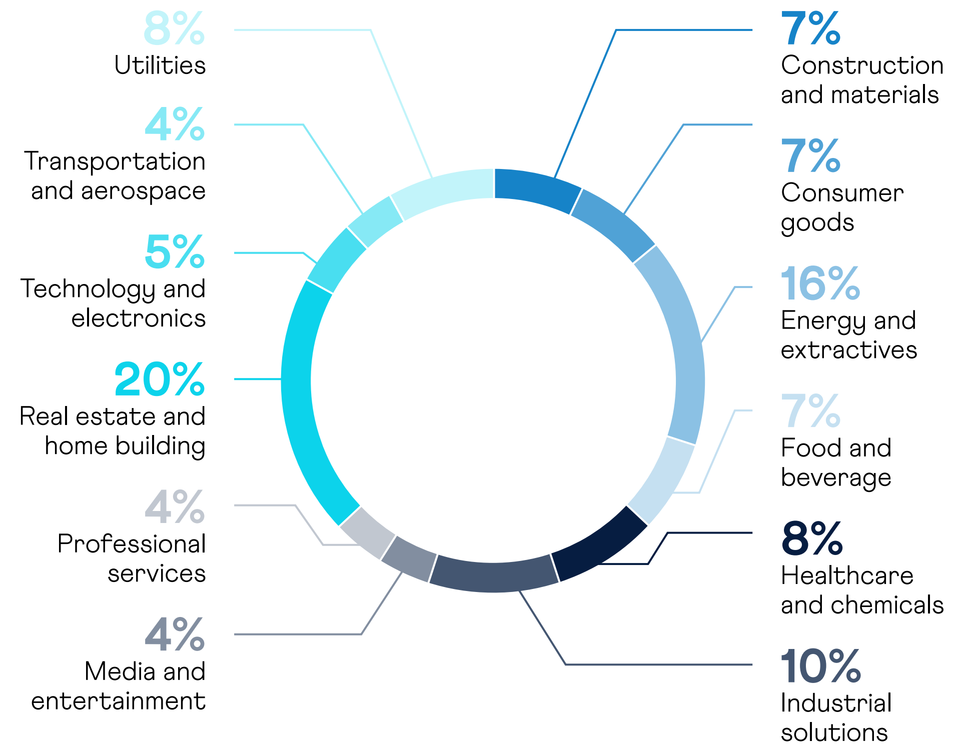
Our findings

Early TCFD reporting represents a melange of approaches. This could undermine the objective of improving the quality and comparability of climate-related financial information, although coalescence around the framework is an important first step towards standardisation. Clear trends are emerging and best practice is still being defined.

In the pages that follow, we examine these trends in where and how to display the TCFD disclosure. We also conduct four "explorations" into the challenges our sample encountered when reporting against the four core pillars: governance, strategy, risk management and metrics and targets.

Who is disclosing?
Of the non-financial constituents of the FTSE 350 index, 102 companies have adopted the TCFD framework ahead of mandatory disclosure in 2022. Representing roughly twelve different areas of economic activity, there is a clear tilt towards climate-sensitive industries with the extractives and real estate sectors comprising 35% of early adopters.

FTSE 350 non-financial TCFD reporters by industry



Our findings continued

Where, and how, are companies disclosing?

The overwhelming majority of companies include TCFD disclosures in their annual report, often as a subsection of sustainability or responsible business sections.

Three distinct presentation approaches have emerged, including:

1. narrative reporting;
2. summary tables; and
3. indices directing readers to disclosures integrated throughout the annual report and sometimes other documents.

52% of the sample opted to adopt a narrative format, but a combination of two or more of these approaches constitutes the emergence of early best practice.

52%
of the sample adopt a narrative format

What are companies disclosing?

Of the companies in our sample, 59% address all eleven recommended disclosure areas. Quality and detail vary considerably. Most of the organisations in our sample provide at least a high-level description of climate governance and disclose related metrics and targets. Companies struggle most to provide meaningful insight into the strategy and risk management components of the framework.

The following recommendations represent the lowest rates of disclosure:

Integration into management: 78%

Climate scenario analysis: 69%

Integration into existing risk management: 78%

★ Look out for the stars to see our recommendations

Where do companies publish their TCFD disclosure?

Nearly every company publishes their disclosure within the annual report. One exception produces a standalone climate resilience report, with links to the annual report. Around 20% of companies also include the disclosure in their sustainability reports. Of these, roughly half use the space available in the sustainability report to provide more detailed information, whilst the other half reiterate content in the annual report.

Within the annual report, about 48% of companies include their TCFD disclosure within the sustainability or responsible business sections, typically as a subsection. The second highest proportion of companies produce a standalone TCFD section. This generally follows the sustainability, risk management or finance review sections.

Where do companies disclose in the annual report?

Financial statements/additional info	10%
Sustainability section	48%
Standalone	27%
Subsection	73%
Corporate governance	3%
Integrated	6%
Standalone section, following:	32%
Sustainability section	50%
Risks	20%
Finance review	20%
Other	10%

★ Our guide to reporting

Materiality should dictate disclosure location

The driving ethos of TCFD is the financial materiality of climate risk. The annual report is therefore its logical home and where the UK has mandated inclusion, specifically pointing to the strategic report. In keeping with the decision-useful intent of the recommendations, we believe all relevant information should be contained within the annual report, unless the volume of the disclosure warrants a standalone report. Likewise, restating the disclosure elsewhere is redundant and unnecessary. It is also essential to ensure that narrative commentary on climate risks and impacts is accurately reflected within the financial statements. We expect that this will be a key criticism companies will face when mandatory disclosure comes into effect.

From a narrative perspective, we encourage companies to position the TCFD disclosure in relation to the relative impact of climate change on the business model. High-impact companies should look to include the disclosure in hard-hitting sections such as the risk review, and a standalone TCFD section or report may be warranted. Ownership of climate risk is another consideration: if responsibility has been delegated to the CFO, for example, it may make narrative sense to have the TCFD disclosure follow the financial review.

19%

of companies clearly present TCFD disclosures on their corporate website

How do companies structure their disclosures?

Three distinct approaches have emerged:

1. **Narrative**
Each of the four core areas are addressed as subsections of a dedicated section or subsection.

2. **Summary table**
A table addressing each of the four pillars or the full eleven recommendations provides a brief summary of the company's progress in that area.

3. **Index**
For companies that integrate their TCFD reporting across the full annual report or in other documents, an index guides readers to where the specific disclosure can be located.

★ Our guide to reporting

TCFD dashboards provide decision-useful detail

Many companies adopt a hybrid approach, whereby a summary table also includes an index. We call this a "TCFD dashboard" and it should include an actionable summary of current year progress and future objectives. This mixed approach best aligns to the spirit of clear, decision-useful and business-material disclosure.

A TCFD dashboard should include an actionable summary of current year progress and future objectives.

Disclosure in practice

Narrative

Experian presents their TCFD disclosure in a clear and simple narrative format.

Index

Pennon Group guides readers to where the disclosure has been integrated within the annual report.

Summary table

Derwent succinctly summarises its progress against each pillar through a summary table.

Hybrid

Drax Group adopts elements of all three approaches, including page drivers to further detail in the report to support its TCFD disclosure.

Exploration

Governance

Virtually every company in the sample describes the board as having oversight of climate issues including strategy, risk and major business and financial decisions. This signals to investors the context in which climate risk is managed. However, integration into management structures is less well developed, which makes implementation across the business more challenging.

Detailed accounts of how the audit, nomination and remuneration committees consider climate issues stand out as a clear example of best practice. Several companies introduce a dedicated sustainability committee that addresses climate risk at board level and feeds into the management team.

The CEO is most frequently identified as the executive with ultimate accountability over issues related to climate change. CFOs, COOs and chief sustainability officers are also frequently named. TCFD or other climate-related steering committees feature as mechanisms for engaging the wider executive team. Infographics that illustrate the chain of accountability are helpful tools to communicate overarching governance structures.

CEOs lead the charge on climate action

Exploration
Governance

★ Our guide to reporting

Governance is foundational to effective management of climate risk

TCFD compliance cannot proceed effectively without the support of the board. Spending time on education and upskilling around climate risk, and addressing FAQs, will enhance board awareness of the impacts of climate change and achieve full buy-in. Climate experience may also need to be a new consideration of nomination committees moving forward. As calls grow louder for auditors to provide external assurance of non-financial information, including climate disclosure, TCFD must also be flagged as a matter for audit committees.

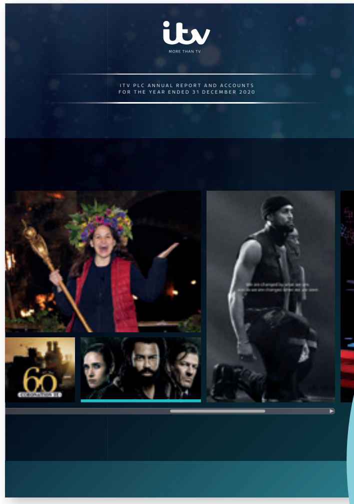
47%

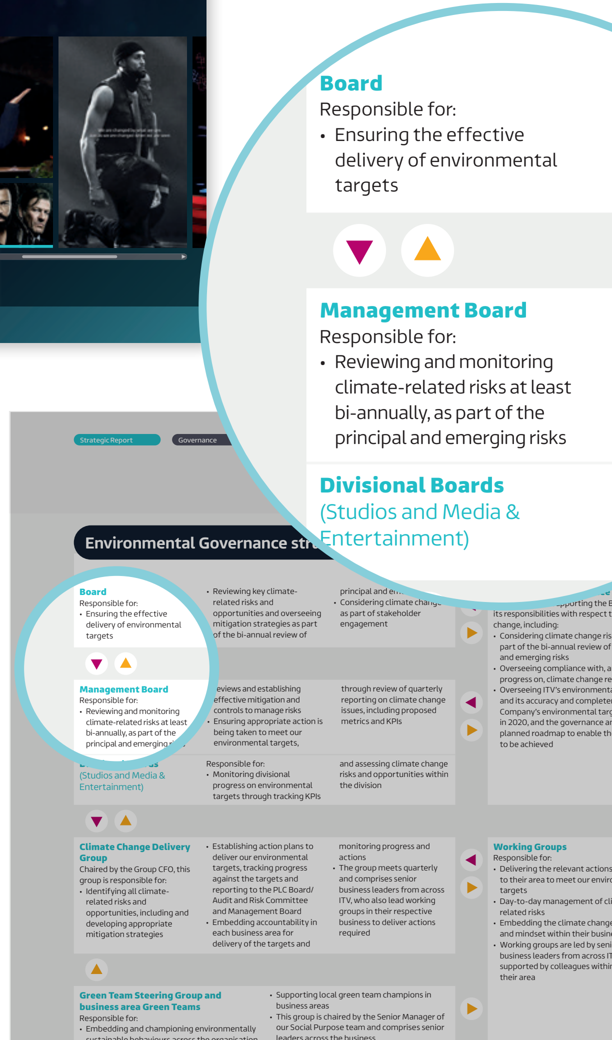
of companies name the CEO as having ultimate responsibility for climate risk

Working groups are useful in rolling out the implementation of climate risk policies and procedures at the management integration level. However, assigning ultimate accountability to a specific member of the C-suite level signals the appropriate gravitas.

Disclosure in practice

ITV provides a detailed infographic representation that illustrates its approach to environmental governance.





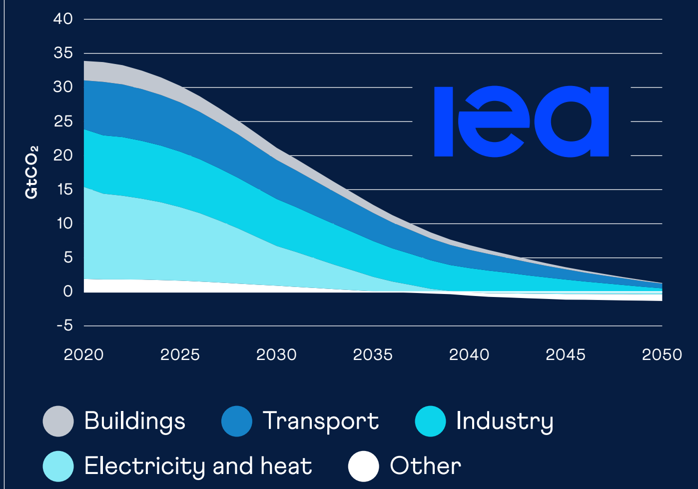
Exploration
Strategy

Disclosures against the strategy pillar represent the widest range of interpretations and quality of reporting, suggesting that this pillar may be the most challenging. Recommendation five, which encourages companies to undertake scenario analysis, is the least-adopted recommendation in our sample. Only 69% of companies disclose against this.

What is climate scenario analysis?

Climate scenario analysis is a process of exploring potential future pathways of development and assessing the resilience of the business against various outcomes. For non-financial companies, it is an excellent exercise to assess the resilience of the organisation to climate-related impacts, as well as to define – and educate decision makers on – the material issues that present both risks and opportunities to the business.

The International Energy Agency's 2021 pathway to net zero scenario supports decision making by policy-makers and business.



29%

of companies used both the IEA and IPCC scenarios

Exploration
Strategy

The Task Force states that climate scenario analysis should be proportionate to the size and nature of each business, and this is reflected across our sample: the rigour and sophistication of scenario analysis undertaken vary considerably.

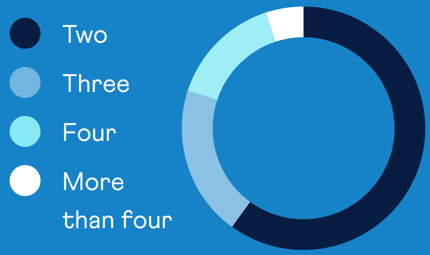
The majority of reporters reference the publicly available IPCC[1] and IEA[2] scenarios. While some of the remaining 41% of companies did not specify an external scenario, many have developed in-house climate modelling tools. TCFD guidance is ambivalent towards the use of public reference scenarios versus the development of in-house ones: while external resources provide credibility and comparability, tailored scenarios can better reflect the potential realities of a given company, geography or sector. For example, National Grid has developed the Future Energy Scenarios in its reporting: these are specifically designed to suit the context of its geography and industry.

1. https://www.ipcc.ch/report/emissions-scenarios
2. https://www.iea.org/reports/world-energy-model
3. This scenario aligns to the goals of the Paris Agreement and is specifically endorsed by the TCFD recommendations.
4. These scenarios fall generally within the scope of a "business as usual" scenario, which can rise as high as 6°C by the end of the century. See https://www.oecd.org/env/cc/43707019.pdf for more information.

TCFD recommends the incorporation of three scenarios in analysis. Companies tend to use just two, usually including a 2°C or lower scenario[3] and a 3 to 4°C scenario[4]. A range of additional factors is considered alongside temperature. For example, the IEA's Sustainable Development Scenario considers how an orderly transition that aligns to the Paris Agreement might evolve in terms of policy and technology. In contrast, the IPCC's Representative Concentration Pathway (RCP) 8.5 Scenario imagines a "worst case" alternative future in which no effective policies are enacted to limit emissions.

Industries for which climate risk is more acute, such as energy and extractives, provide the best insight into how the results of scenario analysis can be disclosed. Best practice examples describe potential financial implications and mitigating action taken.

How many scenarios do companies use?



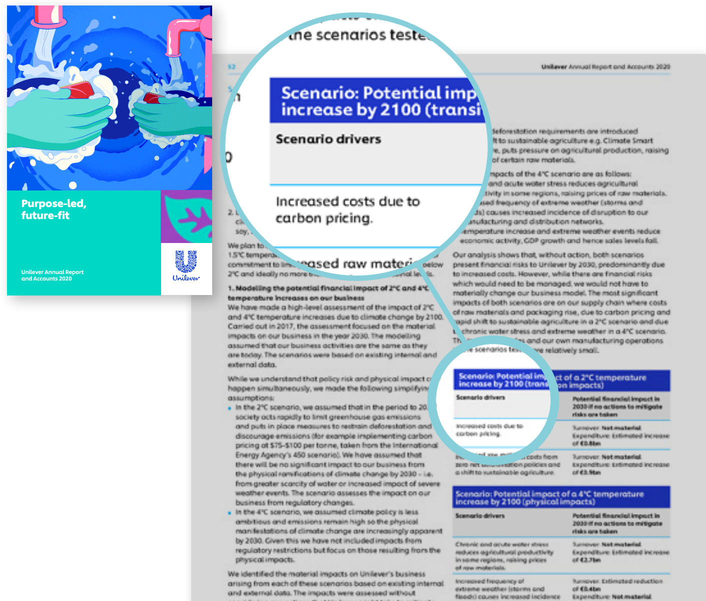
★ Our guide to reporting

Don't side-step scenario analysis

The strategy component of the TCFD framework asks companies to assess the impacts of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning, underscoring TCFD as an exercise in outside-in risk management. We anticipate that uptake in climate scenario analysis will grow as companies realise its effectiveness as a tool for understanding how climate risk impacts the business. Anecdotally, we observed that some FTSE 350 companies are electing to kick-start the TCFD process with scenario analysis, and we recommend embracing this approach as a valuable strategic exercise.

Disclosure in practice

Unilever utilises two scenarios to assess the potential financial implications of climate change on the business. Detail about each scenario is provided, including key assumptions. The company takes the assessment further by modelling the specific impacts on three key commodities in its supply chain.



Exploration
Risk management

Management of climate-related risks is not a well-established practice, and reporting on risk management processes is underdeveloped. The risk management pillar feels susceptible to boilerplate reporting, representing a missed opportunity to communicate how companies are responding to the threat of climate change.

Many of the companies in our sample discuss climate change in the context of their principal risks, with 72% explicitly including climate change as a principal risk and a further 13% including it as an emerging one. However, risk management reporting is uneven and immature. Along with strategy, the risk management pillar is the most unevenly adopted in our sample, and there is opportunity to develop better disclosure of the mechanisms used to identify, assess and monitor climate-related risk. In particular, integration of climate risk management into the broader risk management framework was poorly explained.

13%
of companies designate climate as an emerging risk

Exploration
Risk management

★ Our guide to reporting

Risk disclosure earmarked for future improvement

Risk management disclosure can be improved through clearer signposting between sections to illustrate how climate risk is integrated into risk management processes and financial calculations and assumptions. If companies do not consider climate change in the context of principal risks, they should ask themselves why, and carefully scrutinise their existing risk registrars for interconnectivity with potential climate impacts.

The TCFD reporting process is designed to clarify the materiality of risks that may have been previously undervalued. Physical and transition risks are not currently well understood, with many companies remaining focused on their impacts on the environment, rather than the environment's impact on the organisation. We expect to see significant improvement against this pillar and better disclosure across the board as awareness improves.

72%

of companies in our sample list climate change as a principal risk

Disclosure in practice

Mondi provides insight into its climate-related risks, as well as mitigating activities. The company describes how climate risks are identified and assessed against specific time horizons.

Exploration
Metrics and targets

The metrics and targets pillar underlines the importance of data in facilitating prudent decision making. Challenges around comparable metrics and misleading terminology are obstacles to clear and meaningful targets. Standardisation of reporting norms remains a fundamental gap that the TCFD's latest public consultation seeks to address through the introduction of cross-industry metrics that are more easily translated into financial impacts.

While all companies in the sample disclose greenhouse gas emissions in line with the UK rules for listed entities, some are beginning to introduce more nuanced metrics that give greater insight into industry-specific climate impacts. Some carbon-intensive industries even provide a comprehensive dashboard that gives a brief description of each metric and how it is calculated.

The ambition of climate targets, and lack of clarity on methodologies and scope, stand as obstacles to achieving the goals of the Paris Agreement. Our early adopter sample is making efforts to address this challenge head on, with 72% either currently aligned or in the process of aligning to the Science Based Targets initiative (SBTi).

72%

of companies align to the SBTi

Exploration

Metrics and targets

47% of companies clearly link executive pay to climate-related targets or are in the process of integrating climate performance into their remuneration structures. This suggests a promising trend towards targets backed by accountability and engaged governance.

47%

of companies directly link executive remuneration to climate-related performance

★ Our guide to reporting

Granularity and comparability are necessary next steps

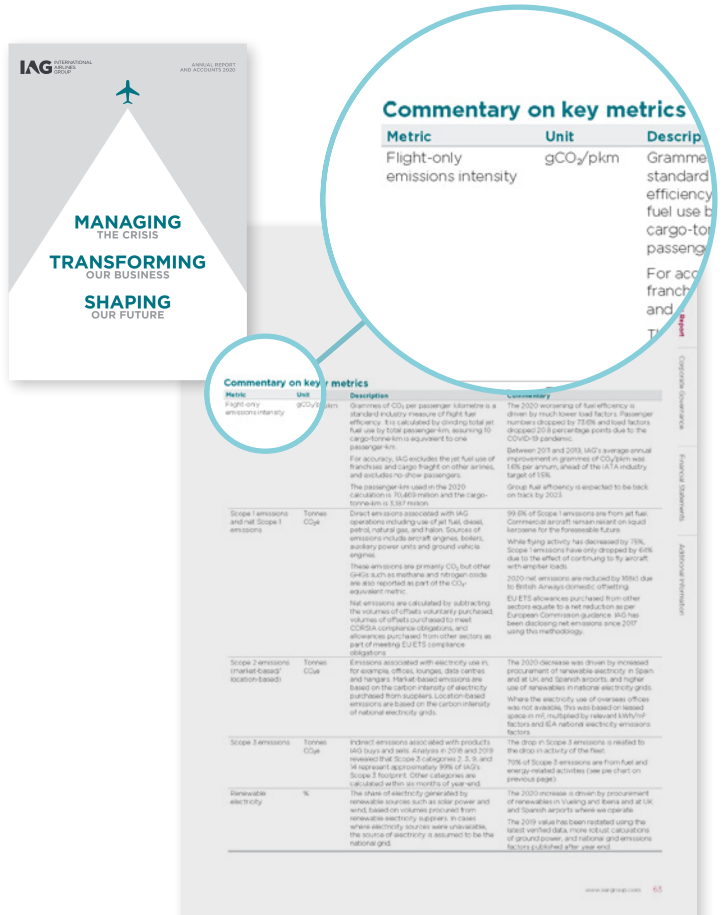
Better alignment between targets and financially material climate impacts must be underpinned by reliable, comparable and decision-useful metrics. The TCFD's plans to introduce more nuanced guidance for the metrics and targets pillar will be a vital step towards better pricing and understanding climate risks.

The comprehensiveness of metrics and associated targets is also facing scrutiny from investors, who in particular want to understand the extent to which Scope 3 emissions represent a material risk to the business. TCFD has also indicated support for disclosure of Scope 3 emissions across all sectors, given the improvements to data gathering methodologies and the significant contribution of Scope 3 emissions to overall carbon output.

Most companies currently set targets against defined timeframes (typically 2030 or 2050). It is likely that pressure will increase to show more granular approaches and to set interim targets so investors can better monitor progress.

Disclosure in practice

IAG clearly describes each climate-related metric used by the company to track progress, including the unit and commentary on performance.



How we can help

At Design Portfolio, we can help you to not just communicate your TCFD journey, but to understand what the climate crisis means for your business, how to assess risks and opportunities, and what can be done to embed climate awareness throughout the business. Get in touch to find out how we can support you at: sustainability@design-portfolio.co.uk

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Stakeholder Engagement Consultant

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Does your business understand which climate risks and opportunities are relevant?

We are able to deliver tailored climate materiality assessments to help your team understand which issues matter most to the business and key stakeholders.

Is your board aware of its responsibilities under TCFD?

Our in-house sustainability consultants are able to conduct tailored workshops to help educate leadership teams on the climate crisis and how to embed climate awareness into governance structures.

How does your business stack up to peers, and what are you already doing that aligns to TCFD?

Our team can conduct a gap analysis of your current reporting alongside a tailored peer review to establish a baseline for your TCFD reporting journey.

Resources:

Consultation on requiring mandatory climate-related financial disclosures by publicly quoted companies, large private companies and Limited Liability Partnerships (LLPs) | **BEIS**

How can climate change disclosures protect reputation and value? | **EY**

Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations | **FCA**

Net Zero by 2050: A Roadmap for the Global Energy Sector | **IEA**

Two thirds of FTSE 100 mention TCFD in reporting, finds research | **IR Magazine**

UK government consults on mandatory climate disclosures for publicly quoted companies, large private companies and LLPs | **Linklaters**

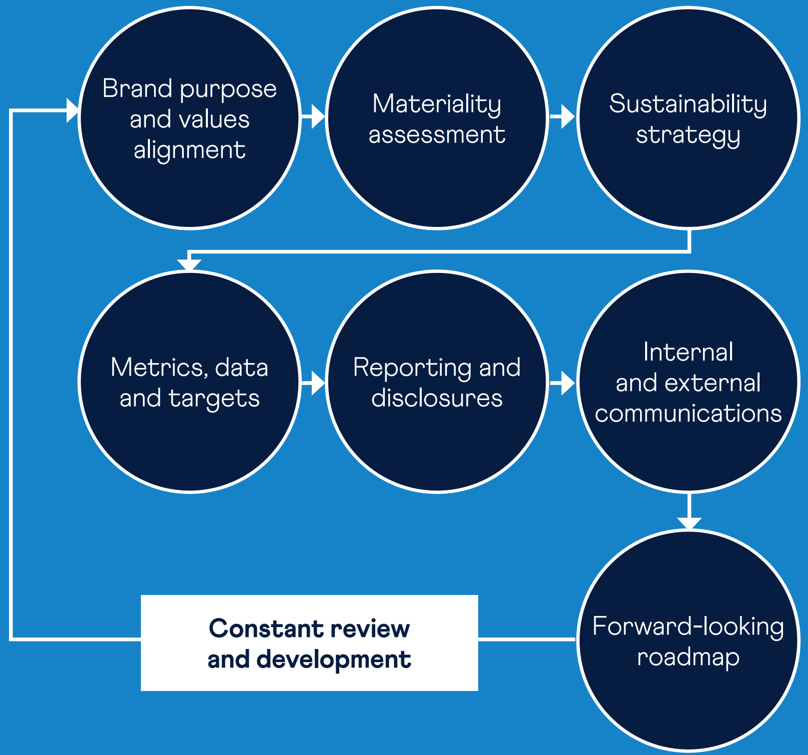
BEIS consultation on requiring mandatory climate-related financial disclosures | **Norton Rose Fullbright**

TCFD Recommendations | **TCFD**

Statement on BEIS Climate-Related Reporting Proposal | **UN PRI**

Sustainability by design

Water scarcity, air pollution, climate change, food security, and city growth. The world's most impressive minds in business, research and politics are convening to ask the question: "How should we organise our economies to take on these issues in the 21st century?"



Disclosure, reporting and regulatory alignment are the first steps to a more sustainable world. And undertaking these commitments already puts a lot on a company's plate. But to really succeed as a business in the 21st century, it's not about reporting, or sustainability as a sideshow to business activity – it's about sustainability by design.

Rather than monitoring and reporting for their own sakes, or as a box-ticking exercise, companies with long-term ambitions should be asking what the data they uncover through reporting actually means for the business. How do operations need to shift and change to take advantage of growing low-carbon markets? How can social factors like equality and diversity be invested in internally to engage a happier, more productive workforce? How can innovative governance and culture lead to long-run success?

Starting with your business fundamentals, your assets, your people and your culture, we help to work through the strategic decisions you need to make to get to a climate-resilient, business-oriented sustainability strategy, and to service all your reporting, investment, data and communications needs.

For more information about Sustainability by design, visit our websites below.

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