



Progressive Investors and Corporate Disclosure

**THE UNSTOPPABLE TRANSITION
TO A RESILIENT, LOW CARBON ECONOMY**

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Preface

CPA Canada would like to thank the interviewees for their time and contributions to this publication.

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We invite readers to submit comments on the issues in this paper.

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Background

The Task Force on Climate-related Financial Disclosures (TCFD) released its recommendations for climate-related financial disclosures in June 2017. The recommendations covered the areas of governance, risk management, strategy, and metrics and targets. Importantly, the recommended disclosures applied to organizations across all sectors, including banks, insurance companies, asset owners and asset managers.¹

In April 2018, the Canadian Securities Administrators (CSA) released its *Staff Notice 51-354 Report on Climate change-related Disclosure Project*. It provided an overview of existing regulatory reporting requirements and, among other things, reported on outreach it conducted with investors and issuers. CSA outreach identified differing views between what investors said they wanted by way of climate-related financial disclosures and what issuers believed they were required to disclose.

This research seeks to advance knowledge about what climate-related information investors use in decision-making and how they use it. It also seeks to understand the impact, if any, of the TCFD recommendations on investor decision-making.



¹ www.cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/mdanda-and-other-financial-reporting/publications/tcfd-overview

Objectives

The objectives of this report are to assist:

1

corporations in providing better decision-useful climate-related financial disclosures

2

institutional investors by sharing peer learning about disclosures and decision-making related to climate-related financial information

3

capital markets generally by identifying potential levers of change to address issues related to the disclosure of climate-related financial information.

Throughout this report, the term “investors” refers to institutional investors interviewed for the purposes of this report.

Scope

In the latter half of 2018, CPA Canada conducted in-depth interviews with 10 institutional investors with assets under management totalling approximately \$1.9 trillion, as well as a bond rating agency and a third-party data provider. Investors were primarily from Canada, with one from the U.S. and one from Europe.



Corporate Disclosures

1. What climate-related information do investors want companies to provide?

In general, investors seek any information that affects or could affect cash flows.

Investors view climate-related risks as pervading all sectors and geographies. As a result, the default view is that climate-related issues are material unless otherwise demonstrated. Therefore, whether a company believes climate-related financial information to be material or not, investors want disclosure about the following from all companies:

- governance, high-level risk management and strategic assessment; without such disclosure, investors are uncertain as to whether management and the board have concluded this information is immaterial or whether they have overlooked it
- scope 1 and 2 greenhouse gas (GHG) emissions; more and more investors seek this information.

Where climate-related financial information is material to a company, investors want relevant information as set out in the recommendations of the TCFD.² Interviewees mentioned the following specific disclosures that are important for some companies to provide:

- the exposure of the organization's specific physical locations and infrastructure, including supply chains, to extreme weather events (e.g., floods, wildfires, ice storms, droughts, early thawing), potential impacts and how the organization is managing its exposure
- water information where critical dependencies exist, including potential impacts of water deficiencies and the company's related risk management processes and plans
- trends and measures to reduce GHG emissions, including targets both absolute and intensity-based.³

² www.fsb-tcfd.org/publications/final-recommendations-report

³ Absolute emissions are defined as total quantity of emissions, typically expressed as tonnes of carbon dioxide equivalents (tCO₂e); intensity-based emissions are total emissions relative to a particular level of economic activity or output (e.g. tCO₂e per dollar of revenue earned)

Investors noted that few companies disclose the physical risks facing specific facilities or the potential impact of severe weather conditions on these facilities.



Physical Risks: A Growing Blind Spot for Companies

A significant amount of research and real-life examples have demonstrated an underappreciation of the growing physical risks of climate change:

Nature Climate Change Journal: “In reviewing more than 1,600 corporate adaptation strategies, we find significant blind spots in companies’ assessments of climate change impacts and in their development of strategies for managing them.”⁴

Pacific Gas and Electric Bankruptcy: In filing for bankruptcy in early 2019 due to liabilities arising from California wildfires, is seen by some as an example of a company that did not adequately manage the risk of adapting to a changing climate.⁵

Asset Values at Risk: While there are initiatives that attempt to show how climate change will impact specific geographical areas,⁶ there is a need to link geographical weather information to specific physical asset and infrastructure locations.

UN Environment Programme Finance Initiative Report on Physical Risks: Along with investors, banks are increasingly concerned about the physical risks of climate change. In a 2018 report, *Navigating a New Climate*,⁷ 16 of the world’s leading banks, including two Canadian banks, developed methodologies to assess the risks and opportunities from the physical impacts of climate change on their loan portfolios.

4 Allie Goldstein, Will R. Turner, Jillian Gladstone and David G. Hole. *The private sector’s climate change risk and adaptation blind spots*. Nature Climate Change Perspective. Volume 9. January 2019. Pages 18–25

5 www.washingtonpost.com/news/monkey-cage/wp/2019/01/30/pacific-gas-and-electric-is-a-company-that-was-just-bankrupted-by-climate-change-it-wont-be-the-last/?noredirect=on&utm_term=.df4e1fc677d7

6 e.g., Climate Atlas climateatlas.ca; WRI Aqueduct Tool www.wri.org/our-work/project/aqueduct; Swiss Re CatNet www.swissre.com/reinsurance/property-and-casualty/solutions/property-specialty-solutions/catnet.html; Canadian Centre for Climate Services www.canada.ca/en/environment-climate-change/news/2018/04/canadian-centre-for-climate-services.html

7 www.unepfi.org/wordpress/wp-content/uploads/2018/07/NAVIGATING-A-NEW-CLIMATE.pdf

Some highlights of specific disclosures about strategy that interviewees mentioned were:

- investee's strategy regarding climate change and the impacts of risks / opportunities on the business model of the company
- opportunities and investments in energy efficiency, clean technology and renewable energy
- internal carbon prices, if any, of investee companies.

Some highlights of specific metrics and targets mentioned by interviewees were:

- financial impact of carbon taxes (current and projected)
- GHG emissions Scopes 1 and 2 (absolute and intensity-based emissions); some are beginning to assess Scope 3 emissions
- methane emissions, a particularly potent GHG emissions
- targets and achievements in reducing GHG emissions.

Investors view climate-related risks as pervading all sectors and geographies. As a result, the default view is that climate-related issues are material unless otherwise demonstrated.

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Attributes of good corporate disclosures:

- ✓ specific and complete (i.e., speak to specific impacts on your business, and avoid boilerplate)
- ✓ comparable within a sector, industry or portfolio (i.e., use common metrics employed by peers, use industry association frameworks, specifically SASB, CDP, TCFD)
- ✓ consistent over time to allow trend analysis
- ✓ reliable, verifiable and objective
- ✓ timely

Information may be both:

- quantitative, where possible (e.g., costs of compliance with regulations, year-over-year trends, etc.)
- qualitative (i.e., narrative to provide context and to support the numbers)

Sources of examples of good disclosures include the TCFD Hub,⁸ TCFD's interim status report,⁹ and CDP top-rated companies.¹⁰ The EY Global Climate Risk Disclosure Barometer¹¹ highlighted attributes of disclosures that were particularly helpful.

Investors interviewed recognized reporting may not be perfect. For example, many interviewees cited an integrated energy company as providing good climate-related disclosures; however, they also noted that the same company failed to acknowledge and quantify the impact and potential impact of Fort MacMurray wildfires which, under different circumstances, could have had a significant impact on operations and financial performance.

2. How do investors use climate-related financial information?

a. Engagement

Investors are increasing their engagement with companies on climate-related financial issues. One area of growing interest is water – the potential impact of either too much (e.g., flooding) or too little (e.g., drought) – on operations, supply chains and financial performance.

As one interviewee stated, “if climate change is the shark then water is the teeth,” reflecting that the most significant impact of climate change in Canada tends to be water-related.

Engagement activities are time and resource intensive. Given its growing importance, some interviewees expressed the need for additional resources to make engagement more effective.

Some asset owners engage directly with investee companies; some external asset managers engage; in a few cases, both the asset owner and external managers engage together. Some prefer to meet with directors rather than management.

Where practical, environmental, social and governance (ESG) specialists within investment organizations prefer portfolio managers to accompany them to engagement meetings.

Some investors expressed disappointment with the level of awareness some company and board representatives demonstrated during engagement meetings on climate-related issues.

8 www.tcfdhub.org

9 www.fsb-tcfid.org/publications/tcfid-2018-status-report

10 www.cdp.net/en/articles/companies/worlds-top-green-businesses-revealed-in-the-cdp-a-list

11 www.ey.com/en_gl/assurance/climate-change-disclosures-revealing-risks-opportunities

b. Proxy voting

Some proxy voting guidelines are general in nature addressing environmental and social factors but not specifically mentioning climate related financial information. Other investors are becoming more explicit in their guidelines concerning climate-related financial disclosures.

Interviewees noted that they assess shareholder proposals on a case-by-case basis. Investors communicated that, to be supported, proposals had to be well crafted, aimed at the right company, and have a compelling, well-explained and transparent rationale.

Companies are well advised to:

- lead or, at a minimum, be in the middle of the pack on climate-related financial disclosures compared to their peers
- understand investor approaches to proxy voting and current hot topics by reviewing investors' proxy voting guidelines.

c. Integration into investment decision-making processes (buy, hold, sell)

In addition to using climate-related financial information for engagement and proxy voting, investors noted several other uses in investment decision-making, including:

- developing a portfolio strategy (e.g., some investors have established absolute and/or intensity-based emissions targets for their portfolios) to manage the carbon-footprint budget by asset class
- encouraging the disclosure of GHG emissions and the setting of future emission targets and/or investments in innovative emissions-reduction solutions at investee private equity companies
- evaluating and calculating compensation of both investment and non-investment teams throughout the organization; this is seen as a key element of change management
- incorporating into a climate-change or ESG assessment / note from the in-house ESG team to the portfolio managers that accompanies every investment analysis

- assessing the climate-related governance of the investee companies, including assignment of responsibility to oversee climate-related issues, initiatives to reduce the carbon and/or intensity, climate integration into strategy, and level of CEO involvement
- evaluating potential private equity investments
- building into exclusionary screening
- using for their own TCFD reporting (see Section 5 later in the report).

Investors noted that some companies question whether investors really use climate-related financial disclosures. Interviewees reported hearing that some companies:

- maintain that analysts do not ask about climate-related financial information on investor conference calls and in engagement meetings

However, investors noted:

- While not all investors are as far along in using all the information listed above (a few of the interviewees are significantly more advanced than the others), climate-related financial disclosures are on the radar of all investors interviewed. Most have plans to improve their attention to these issues.
- Some investment decisions are made without the need for asking questions. For example, some investors noted that climate-related data already obtained from the company or from external sources was instrumental in their investment decision on certain companies. (Generally, ESG specialists within investor organizations provide climate-related financial information on every investee and potential investee to the portfolio managers.)

- state that many portfolio managers do not read corporate social responsibility (CSR) reports

However, investors noted that these portfolio managers rely on ESG specialists within their organizations to scan CSR reports and other sources and provide to the portfolio manager an analysis of the climate-related financial data.

- indicate that some portfolio managers do not believe climate-related financial information to be relevant to investment decision-making; these portfolio managers may view their fiduciary duty as “making returns” and do not believe that climate-related issues impact cash flows over their investment time horizons.

CFA Institute Position on ESG Integration:

“CFA Institute encourages all investment professionals to consider ESG factors, where relevant, as an important part of the analytical and investment decision-making process, regardless of investment style, asset class, or investment approach ... ESG factoring is consistent with a manager’s fiduciary duty to consider all relevant information and material risks in investment analysis and decision making.”¹²

In response, many investors noted that investment time horizons do impact the materiality of climate-related financial information. In addition, they noted the cultures within investment organizations are changing rapidly. As the costs of climate impacts are becoming more apparent, more portfolio managers see the value in considering climate-related financial information in investment decisions in the short, medium and long terms. Importantly, younger portfolio managers and analysts are attracted by, and welcome, the cultural change.

3. Clues to Determining Materiality

Companies are well-advised to understand how investors determine materiality of climate-related issues.

Judgment of global portfolio managers, analysts and other team members plays an important role in determining materiality. The portfolio manager ultimately makes the materiality determination in buy / hold / sell decisions.

Most of the interviewed investment organizations (usually the ESG team but sometimes portfolio managers themselves) start with the Sustainability Accounting Standards Board (SASB) Materiality Map and adjust as portfolio managers deem necessary. Investors also use industry-specific guidance, Global Reporting Initiative (GRI) standards, CDP survey responses and reporting by peer companies in the same industry sector to assist in identifying material climate-related issues.

Investors noted that sector, investment time horizon and asset class are important determinants in assessing materiality. Given the transition to a low carbon, climate resilient economy will take time, investors viewed the materiality of climate-related issues differently across time horizons by sector and asset class. Trends (e.g., direction of GHG emissions, societal preferences for electric cars) are also important to determining materiality across time horizons.

12 January 2019. cfainstitute.org/advocacy/policy-positions/positions-on-environmental-social-governance-integration

Some investors have begun to take a more total fund approach to quantifying the financial risk from climate change and the energy transition. They have quantified the risk at the asset class and sector level, relying on methodologies that combine integrated climate models (addressing issues such as technology, resource availability, physical impact and policy) with expert judgment to estimate the impact and probability of risks.

4. Sources of Climate-Related Financial Information

Every investor and bond rating organization interviewed buys climate-related financial data from third-party data providers.

Third-party data providers that were specifically mentioned were, in alphabetical order:

- Bloomberg
- Carbon Delta
- Factset
- ISS Climate Solutions (formerly SouthPole)
- Mercer
- MSCI
- Russell
- S&P
- Sustainalytics
- SwissRE CATNET map services
- Trucost
- TruValue Labs
- WRI Aqueduct tool (physical risk)
- YourSRI

Many investors find useful information in corporate responses to the CDP survey.

Investors preferred receiving data directly from companies. While they appreciated the reliability of data provided in audited financial reports, many found this information to be boilerplate, that is lacking the detail and strategic context found in other sources provided by companies such as Annual Information Forms, Management Discussion & Analysis reports, corporate websites, CSR reports, CDP responses. While not preferred, investors also use purchased and other external data sources (e.g., social media, third-party data providers).

Every investor and bond rating organization interviewed buys climate-related financial data from third-party data providers.

Regarding information from third-party data providers, investors often feel it is necessary to review the data for accuracy and reasonableness. Also, investors prefer to use their own weightings and assessments as they often find that third party data providers are not transparent about the methodologies and judgments they use / apply.

Companies are well advised to consider that third-party data providers are not always transparent about the effectiveness of their internal controls and processes, and what, if any, information is subjected to independent verification. Some third-party data providers rely on the company to identify any errors or incomplete information.

5. Investor Adoption of the TCFD Recommendations

As of February 2019, more than 580 organizations issued statements of support for the TCFD recommendations, including 11 Canadian investors.¹³ Several investors interviewed have committed to providing reporting based on the TCFD framework. Further, some investors have their external auditors review these reports.

Few have reported using science-based scenarios, that is scenarios to keep the global temperature increase to below 2 degrees Celsius compared to pre-industrial temperatures, but some are collaborating with global peers to develop the necessary information.

Some investors have begun to specifically ask their investee companies to report in line with the TCFD framework.



In February 2019, the Principles for Responsible Investment (PRI) announced its intention to mandate that signatories report their strategy and governance climate risk indicators effective 2020. These indicators are aligned to the TCFD recommendations.

Climate Action 100¹⁴ is an investor initiative aimed at urging the world's largest greenhouse gas emitting companies to take action on climate change. Signatories ask corporate boards and senior management to:

- implement a strong governance framework
- take action to reduce GHGs across the value chain
- provide enhance corporate disclosure in line with the recommendations of the TCFD.

A number of Canadian institutional investors are signatories to these initiatives¹⁵ and will be asking that companies provide the necessary disclosures.

¹³ www.fsb-tcfd.org/tcfd-supporters

¹⁴ www.climateaction100.org

¹⁵ Twelve Canadian asset managers / pensions, six banks and 4 insurance organizations have expressed their support for the TCFD.

Leading Practices of Investors

Asset owners and managers interviewed who appear to be leading in their efforts to factor climate change into their decision-making and disclosures do the following:

Engagement

- Engage on climate-related issues with investee companies, including encouraging the adoption of TCFD recommendations.
- Focus efforts on the acute and chronic physical risks of infrastructure and other physical assets, in addition to transition risks (policy / legal, technology, market, reputation risks).

Proxy Voting

- Consistently vote their proxies in favour of those climate-related proposals that are reasonable and address issues material to the company.¹⁶

Mainstream Analysis and Outreach

- Ask questions about climate-related issues during mainstream investor calls.
- Include climate-related financial information in mainstream sell-side analyst reports.
- Encourage more dialogue between ESG teams and investment analysts / portfolio managers within investment organizations.
- Continue to experiment with using artificial intelligence for information and data analysis, and to study the style and strategies of external asset managers.^{17, 18}

Allocation of Investment Capital

- Use investment capital to support low-carbon, climate-resilient investment opportunities.
- Use investment capital to support innovative market disruptors in the transition to a low-carbon economy.
- Identify and monitor a series of leading indicators that provide early signs of key industry trends that could indicate the pace and direction of the transition to a low-carbon, climate-resilient economy.

¹⁶ This includes both passive and active investors.

¹⁷ e.g., www.gpif.go.jp/en/investment/research_2017_1_en.pdf

¹⁸ e.g., www.top1000funds.com/2018/10/ai-to-transform-gpif-manager-selection



Internal Change Management

- Integrate climate-change factors (qualitative and quantitative) into portfolio manager, executive and staff compensation.
- Provide formal education programs for portfolio managers and investment committees.

External Asset Managers

- Include the integration of climate-change issues in investment decision-making in external asset manager selection and evaluation.

External and Internal Reporting

- Compare and disclose climate-related disclosures against those of peers.

Collaboration

- Encourage and allocate resources to internal peer education (e.g., share best practices among portfolio managers who operate in different countries).
- Join international investor collaborations seeking to engage more effectively and consistently on climate-related issues (e.g., Climate Action 100+).
- Continue to work with peers to influence climate-related government policies.

Levers of Change

Investors offered a number of suggestions that, if adopted, would be levers of change in improving the quality of climate-related financial disclosures in capital markets. These include:

Investor Recommendations to Companies

- Participate in peer collaborations on efforts to improve climate-related financial disclosures, including global peers as feasible.
- Work with industry associations to establish a set of comparable, industry-specific, climate-related disclosures, including assumptions underpinning scenario analysis.
- Provide more entity-specific (i.e., avoid boilerplate), comparable climate-related financial information together with impacts to ensure the company is telling its own value-creation narrative.
- Disclose GHG emissions (Scope 1 and 2).
- Establish a strong tone-from-the-top on climate-change issues.
- As relevant and tied to corporate strategy, integrate climate-change factors (qualitative and quantitative) into compensation.
- Provide only information that is relevant to long-term value creation and state why other information that is not provided is not relevant.
- Improve reliability of climate-related disclosures by having them independently verified as feasible.
- Consider how climate-related information applies to existing accounting standards, including those on fair value measurements, impairment assessments, asset retirement obligations, contingent liabilities, use of specialists, and materiality assessments.



Investor Recommendations to Industry Associations

- Through member collaboration, lead in the establishment of a set of comparable industry-specific, climate-related disclosures, including consistent assumptions underpinning scenario analysis.
- Act in the long-term best interests of members operating in global capital markets by supporting appropriate climate-change policy actions.

Investor Recommendations to CPAs in Audit and Assurance

- Consider how existing accounting and assurance standards apply to climate-related financial information, including those on fair value measurements, impairment assessments, asset retirement obligations, contingent liabilities, use of specialists, and materiality assessments.
- Help companies to identify those climate-related issues that are financially material to investor decision-making.

Investor Recommendations to Third-party Information Providers

- Provide effective tools for identifying and quantifying physical risks (e.g., meteorological and/or insurance data).
- Focus on forward-looking GHG emissions trends, not only backward-looking data.
- Assess internal controls and processes, including the need for independent verification.
- Be transparent about methodologies, assumptions and data sources.

Investor Recommendations to Beneficiaries and/or Clients:

- Ask your pension fund or asset manager how they are considering climate-related issues in the funds / assets they manage.
- Ask if they have any strategies / plans to intensify those efforts and, if so, what are they.

According to Nordea, one of Europe’s biggest banks:

“ ... moving your savings to sustainable funds can be 27 times more efficient in regard to improving your personal carbon footprint than eating less meat, using public transport, reduce water use, and flying less, combined.”¹⁹

Investor Recommendations to TCFD

- Continue to develop consistent, science-based, climate-change scenarios for use by asset owners, asset managers and companies in their disclosures.
- Continue to maintain a global database on best practice in climate-related financial disclosures and associated tools.

Investor Recommendations to CSA

- Consider the need for guidance and/or regulation about disclosure of an issuer’s materiality assessment for climate-related information.
- Because climate change is a systemic risk, consider mandating governance disclosures irrespective of materiality consistent with TCFD recommendations.
- Consider requiring Scope 1 and 2 GHG emissions reporting to support investor decision-making and assessment of trends.
- Consider enhancing safe harbour provisions to enable forward-looking climate-change scenario disclosures in regulatory filings.

Investor Recommendations to Federal, Provincial and/or Municipal Governments

- Harmonize federal and provincial climate-change policies and implement mechanisms to provide policy certainty beyond election cycles.
- Clarify the interpretation of institutional investors’ fiduciary duty relative to climate change.
- Require crown corporations to provide the recommended TCFD disclosures, adjusted appropriately.
- For municipal governments, provide the recommended TCFD disclosures, adjusted appropriately.

¹⁹ www.nordea.com/en/sustainability/sustainability-news/Use-your-savings-to-lower-your-carbon-footprint.html

Conclusion

Investors are clearly seeing the business imperative related to assessing climate-related financial information and the risks of not doing so. While there are evidently some leading investors, all investors recognize that a transition to a low-carbon economy is happening and there will be significant investment opportunities and risks associated with this transition.

Successful companies will pay attention.



Where to Find More Information — CPA Canada Resources

Publications:

- [Interview with EY: Auditor’s Perspective on Climate-related Risk](#) (2018)
- [Primer for CPAs on GHG Emissions Management](#) (2018)
- [Are Canadian Businesses Managing GHG Emissions?](#) (2018)
- [Climate Change Briefing: Questions Directors Should Ask](#) (2017)
- [Study of Climate-related Disclosures by Canadian Public Companies](#) (2017)
- [Accounting for Cap and Trade Systems](#) (2017)
- [Climate Change Adaptation Case Studies](#) (2016)

Videos:

- [TCFD Overview](#) (2018)
- [Canadian Perspectives on the TCFD Recommendations](#) (2018)

Webinars:

- [Overview of Sustainability Trends and Reporting Frameworks](#) (2019)
- [Investor Trends and Perspectives on TCFD Recommendations](#) (2018)



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