Climate-Related Reporting in the Energy Sector

ROUNDTABLE REPORT

There is growing widespread appreciation of the economic and societal implications of climate risk among investors which has led to the rise of Environmental Social and Governance (ESG) investing[1] and a global push for more climate-related financial disclosure. For natural resource companies that have direct exposure to extreme weather risk and are under the microscope in terms of their environmental impact, the pressure is on.

Against that backdrop, TMX Group and Chartered Professional Accountants of Canada (CPA Canada) have turned their attention to the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). On July 16, 2019, TMX and CPA Canada convened a roundtable of Canadian finance, legal, sustainability, and investor relations professionals from energy companies listed on the Toronto Stock Exchange to understand where the sector is headed with respect to climate-related financial disclosure.

1 CPA Canada, *Investor interviews on climate disclosure and decision-making: Key findings*, May 2019

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The conversation took shape around the findings from a series of interviews with institutional investors conducted by CPA Canada to gauge how they are using climate-related information and the specific types of information they are looking for from companies.

Outlined below are several common themes which surfaced during the roundtable discussion.

Too many questions, not all are applicable

Roundtable participants expressed concern over the proliferation of sustainability-related reporting frameworks, questionnaires, rankings, and surveys that have emerged in recent years. Small-cap issuers, in particular, have disclosure fatigue and are unsure where to focus their efforts. Participants also questioned the methodologies employed by some ESG ratings agencies and commented that some questions directly impacting their scores are not even applicable to their industry and businesses (e.g., questions relating to child labour which is illegal in Canada.)

> **"They [European investors] tend to focus on things that matter and ask specific questions because they have been doing this longer."**
>
> **— ROUNDTABLE PARTICIPANT**

Roundtable participants indicated they spend considerable time ensuring their disclosure is complete and accurate. From their perspective, they feel they should only disclose the information that is important and relevant to their business and should not be forced to report unnecessary details. Roundtable participants commented that European investors tend to ask more specific questions focused on material ESG issues.

Rating agencies can give vastly different scores

Roundtable participants highlighted the growing importance of ESG scores and how they could open doors to many conversations and opportunities. One participant mentioned that an insurance firm only talked to them because of its favourable ESG score.

Roundtable participants raised the question of whether their company's score would be damaged if they stopped reporting under one reporting framework and changed to another (i.e., Task Force on Climate-related Financial Disclosures recommendations [TCFD] vs. Global Reporting Initiative [GRI] vs CDP [formerly Carbon Disclosure Project]).

> **"If I abandon this standard next year and follow another standard, would that ruin my score?"**
>
> **— ROUNDTABLE PARTICIPANT**

> **"The insurance company said they only spoke to me because of my rating agency score".**
>
> **— ROUNDTABLE PARTICIPANT**

Several roundtable participants commented on the benefits of engaging with investors directly in order to better manage their messaging and narrative around exposure and management of climate-related issues.

It is a team effort

The composition of the teams responsible for climate-related disclosures differed among the companies represented by roundtable participants. For instance, some organizations have ESG specialists within their investor relations department while others highlighted that traditional finance groups are taking a more active role over climate-related disclosure.

A common theme was that disclosure requires co-ordination and co-operation across multiple functions (e.g., investor relations, corporate communications, finance, legal, health and safety, and sustainability). Overall, participants noted that no single department can take sole responsibility over climate-related disclosures, but rather that it is a team effort to satisfy the disclosure requirements of different frameworks, regulators and investors.

> **"It is a huge resource strain"**
>
> **— ROUNDTABLE PARTICIPANT**

> **"We are trying to have ESG integrated in the organization and then a slimmer body of experts to knit it together."**
>
> **— ROUNDTABLE PARTICIPANT**

It was also noted that it was important for ESG to be embedded within the culture of the company and that tone from the top drives activities in this area.

Issuers prefer to include climate-related disclosure in stand-alone reports

Many roundtable participants prefer to include climate-related information in a stand-alone report because it gives them more flexibility to provide details. One participant highlighted that financial statements already include many assumptions and that adding further climate-related assumptions in financial statements would make it difficult for investors to follow. Participants highlighted that because they are unclear as to how these assumptions could be audited, auditing could pose a challenge to regulators and auditors.

> **"There seems to be a lot of activities to try to put numbers in audited financial statements without thinking through how to actually get there ... Financial statements are so full of estimates and assumptions and forecasts that they [ESG numbers] become meaningless"**
>
> **— ROUNDTABLE PARTICIPANT**

CSA Staff Notice 51-358 *Reporting of Climate Change-related Risks* (issued August 2019)[2] includes a discussion of "guiding principles" for determining materiality, reinforcing and expanding upon the guidance included in CSA Staff Notice 51-333 *Environmental Reporting Guidance*.

Scenario analysis is challenging

Participants agreed that the scenario analysis requirements under the TCFD recommendation is especially challenging for a number of reasons:

- There is concern about the appropriateness and scrutiny over forward-looking statements because of securities laws.
- The assumptions that need to be made to provide scenario analysis can be extremely difficult to make because of unknowns that could affect technology advancement, regulatory changes as well as unknowns concerning the impacts of climate change itself.
- There was concern about how these uncertain projections might be viewed by investors.

Participants agreed that more guidance should be provided to help issuers with scenario analysis.

2 CSA Staff Notice 51-358, *Reporting of Climate Change-related Risks*; www.albertasecurities.com/-/media/ASC-Documents-part-1/Regulatory-Instruments/2019/07/5472091-FINAL_CSA_SN_51-358_for_publication_Aug_1.ashx

Get the narrative out there

Participants stated that ESG integration has been part of their companies' culture and operations for a long time; what has changed is the increased demand for disclosure coming from investors and regulators.[3] The fact that the financial industry has started to pay attention to safety and environmental metrics is a positive for the energy sector.

> "We have been doing this for a long time. The shift is the demand for disclosure"
>
> — ROUNDTABLE PARTICIPANT

Many participants commented that the Canadian energy sector should be proactive in bringing issuer stories to the market and directing investors to the area they believe matters the most to them. This should include how the sector is addressing climate-related risk and the progress it has made to reduce negative environmental impacts on a global scale.

Closing thoughts from participants

To conclude, participants were asked to identify one challenge / clarification they would like addressed. Some comments included:

- There is a need for a united communications effort by all the participants in the Canadian energy sector to demonstrate it is one of the greenest and most ethically managed fossil fuel industries globally.
- Broader comparisons of climate risks across most business sectors would be valuable. For example, participants noted that it would be helpful to see an analysis that demonstrates how some non-resource-based companies, like those involved with distribution / transportation of goods, also have a significant carbon footprint.
- There is a need for standardization and consolidation of ESG disclosure frameworks in order to reduce the time and resources it takes to disclose.
- There is also a need to provide investors with a simpler, more consistent and comparable way to access ESG information.

For more information and guidance on climate-related disclosure, please visit www.cpacanada.ca/tcfd and www.tsx.com/learning.

3 CSA Staff Notice 51-358, *Reporting of Climate Change-related Risks*; www.albertasecurities.com/-/media/ASC-Documents-part-1/Regulatory-Instruments/2019/07/5472091-FINAL_CSA_SN_51-358_for_publication_Aug_1.ashx

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