World Environment Center

Accounting Methodologies and Goal Setting – TCFD & Natural/Social Capital Valuation
Executive Roundtable Summary
Basel, Switzerland - March 21-22, 2019

Background

With growing empirical evidence that high sustainability performance provides better financial returns, capital is being allocated to companies with good performance on material sustainability issues. The Task Force on Climate-related Financial Disclosures (TCFD) is a clear example of the finance community taking steps to better align ESG-reporting with investors' needs. However, purpose-driven company strategies and new accounting methodologies to understand the business impact on nature and society may help investors to further distinguish between risky laggards and well-managed outperformers. Some of the leading companies, think-tank experts and investment firms gathered in Basel to discuss current trends.

Participants

Hosts and Sponsors

- Dr. Peter Schnurrenberger, Roche Group Chief SHE Officer, F. Hoffmann-La Roche
- Sabine Hoefnagel, Global Director Strategy, ERM

Moderators and Facilitators

- ERM: Sabine Hoefnagel and Charles Allison
- F. Hoffmann-La Roche: Dr. Peter Schnurrenberger
- Natural Capital Coalition: Mark Gough
- Sustain Value: James Spurgeon
- WEC: Lori Michelin and Frank Werner
- WEC Europe Supervisory Board: Dick Bartelse

Speakers

- APG Asset Management: Dr. Lucian Peppelenbos
- Arabesque Partners: Georg Kell
- BASF: Christian Heller
- CDP Europe: David Lammers
- CDSB: Nadine Robinson
- Credit Suisse: Bruno Bischoff
- Dow Chemical: Dr. Jihane Ball
- F. Hoffmann-La Roche: Thomas Wolf
- LafargeHolcim: Antonio Carrillo
- RobecoSAM: Dr. Roland Hengerer
- Scheiwiller Impacts: Thomas Scheiwiller
- Syngenta: Marina Prada
- treeze: Dr. Rolf Frischknecht
- WBCSD: Eva Zabey

Key Points

(1) Digitization and decarbonization are driving market transformation. As the public and private spheres are increasingly converging, we are moving from the industrial era to something that may be called "future fit". For example, strategy is moving from profit, scale and analog to purpose, speed and digital. Figure 1 below illustrates transformational shifts are also impacting the way we look at organizations, natural resources, policy/ society and energy use. Companies moving in these directions are future-proofing their organizations.

(2) Solid sustainability correlates to strong operational and stock performance. Financial experts and investors shared data that indicated companies with superior sustainability performance significantly outperform in the stock market. As a result, capital is increasingly being allocated towards companies with higher sustainability performance. Reference was made to a Harvard Business Review publication Corporate Sustainability: First Evidence on Materiality which concluded that investments in material sustainability issues can be value-enhancing for shareholders.

(3) **Most wealth, trust and asset management companies are integrating sustainability parameters into their investment decision making process.** Investors now have in-house ESG expertise, responsible investment policies and IT solutions that evaluate company's sustainability performance as part of their investment decision making process. Arabesque referenced their S-Ray Tool which combines over 200 environmental, social and governance (ESG) metrics with news signals from over 50,000 sources to provide an industry-specific assessment of companies' performance on financially material sustainability criteria (ESG Score). APG Asset Management referenced their Responsible Investment & Stewardship Policy that includes an expectation for corporations to support the UN Global Compact along with other requirements. Discussions also recognized TCFD and contribution to the UN Sustainable Development Goals as an important consideration.

(4) **Investor relations indicates that there are geographic differences in levels of engagement on sustainability.** Beyond specialized sustainability investors, large pension funds especially in the Benelux-countries, Scandinavian region and UK are actively screening their portfolios on sustainability risks and opportunities with their own qualified teams. As a general matter, Investor Relations officers are witnessing the most robust integration of sustainability aspects from European investors, a bit less from North American investors and little to no engagement from investors in developing markets.

(5) **TCFD was developed because climate change is a material risk for financial markets – financial markets and companies are at the beginning of the implementation journey.** While still a voluntary framework, the EU as well as countries such as Canada, France, and Switzerland are investigating an alignment with their mandatory disclosures. It was anticipated that adoption will continue to grow as companies and investors increasingly understand the financial implications of climatic risk. For companies seeking to learn more about TCFD, it was recommended that they benchmark practices with peers in their industry sector given similar risk profile, join preparer forums to better understand requirements and scenario analysis, integrate climate change into the company's existing governance process with board buy-in (audit and risk committees), and align on roles and responsibilities with governance, compliance and finance departments. CDSB referenced First Steps on Climate-Related Financial Disclosures in Europe as well as a checklist to get ready for the Task Force recommendations.

(6) **TCFD is likely to not be extended beyond climate.** With TCFD successfully bringing climate change to the attention of investors, Roundtable participants discussed whether the TCFD framework should be applied to other material sustainability issues. It was argued that parts of the TCFD recommendations for disclosure, such as the high-level structure would be useful – major details such as scenario analysis, however, are not suitable for several topics.

(7) Disclosure expectations continue to grow, prioritization is essential. Since the release of the GHG-Protocol and GRI guidelines in 1997 the number of reporting frameworks has exploded, reflecting the information requirements of numerous stakeholder groups. While many companies desire integration of expectations, progress is still relatively slow. The future of reporting is likely to be about real time and forward-looking information sharing, and more tailored to different audiences. Companies should continue to engage and disclose in a prioritized manner. ERM referenced their report Expert Views on ESG Ratings.

(8) Nature has a value and can compete for financial resources and capital. Dow shared their program Valuing Nature. As part of it, Dow is screening all capital and real estate projects, business development and new products for potential benefit and impacts. Dow collaborated with the Nature Conservancy and the Ecometrix Solutions Group to develop the ESII tool that allows their team assess ecosystem services rapidly and cost-effectively in order to identify and incorporate the value of nature into business decision making. By thinking differently, nature-based solutions are being integrated into their portfolio of projects and delivering savings to the bottom line.

(9) Methodologies that have been around for assessing environmental impact are also suitable to be translated into a monetary unit, as Natural Capital Valuation suggests. Comparison of BAFU Eco-Balance according to the Ecological Scarcity Method, Natural Capital Protocol, DELFT Environmental Prices and Environmental Priority Strategies in Product Design revealed appreciable differences in estimation of individual impacts, however, all are considered indicative and the aggregated total yields similar results. Until there is convergence on methodology, it is important for organizations to select and use a single method so that results are comparative and consistent to inform internal decision making. It is also necessary to understand that Natural Capital Evaluation serves as a management tool that informs decision making to effectively making a positive change. To convert environmental impact to a monetary unit, the price of carbon can be used as an anchor point/proxy for a conversion unit.

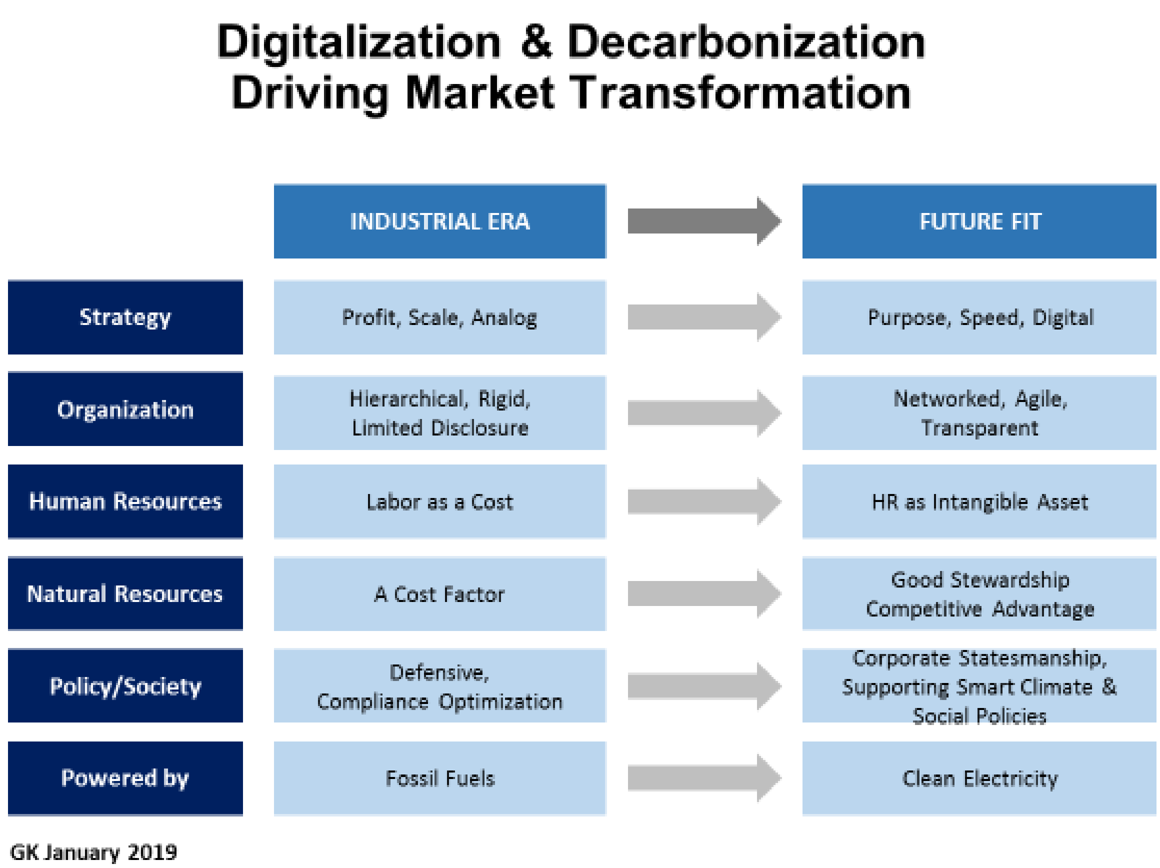
(10) Some companies are using impact valuation and disclosing an integrated P&L. In order to integrate costs that have been externalized for too long, impact valuation methodologies have emerged, and some organizations are disclosing integrated P&L's. Early movers in this space shared their experiences - it was recognized that the process is rather new and comes with inexactness, so companies advised that: 1) it expanded thinking on matters, 2) enabled better long-term decision making and 3) there was no negative stakeholder reaction. It was estimated that over 300 companies are piloting impact valuation, however, very few are disclosing an integrated P&L.

(11) Given the growing number of initiatives and platforms in this area (as noted above) the OECD is sponsoring an alliance to: standardize a model and calculation tool, align external disclosures, pilot in decision making and steering and make the outcome available via the OECD. The topic is considered experimental at this time; while investors are engaged with the OECD Alliance, participants indicated that there is currently no market demand for integrated financial statements.

(12) Financial Statements of the Future (?): Roundtable participants entered environmental and social data into an integrated P&L of an imaginary company as an exercise to illustrate natural and social capital valuation. While the value creation on singular issues changed depending e.g. on the emissions, employee wages or tax-payments entered into the form, there wasn't always agreement as to whether financial statements of that kind are practical or even desirable. It was criticized that such an intended level of convergence and focus on a single monetary number has the potential to obscure deficits in single areas (although not necessarily). The tool itself was recognized as a way to expand thinking and a possibility to drive change – investors, however, are still far from using something alike.

Note: WEC Executive Roundtables are conducted under the Chatham House Rule, companies are mentioned in the summary with their permission – this practice is applied only when information/resources are publicly available.

Figure 1. Digitalization & Decarbonization Driving Market Transformation



Source: Georg Kell, 2019