Report

FTSE Russell

How the TCFD recommendations are incorporated into FTSE Russell's ESG Ratings and data model

Background

In December 2015, the Financial Stability Board chair Mark Carney announced the establishment of the Task Force on Climate-related Financial Disclosures (TCFD) with Michael Bloomberg as chair. The aim of the task force was to deliver a voluntary, consistent climate-related financial risks disclosure framework in order to provide material information to investors, lenders, insurers and other stakeholders. Institutional investors with more than US$ 25 trillion assets under management have subsequently backed the final recommendations of the Financial Stability Board's TCFD.

The Task Force has continually outreached to companies and investors, and it has encouraged industry-specific forums such as the World Business Council for Sustainable Development to help implement the recommendations. Early in 2018, TCFD will launch the TCFD web-based knowledge hub, which will provide tools and other implementation resources.

The TCFD's final recommendations focus on four core themes: governance, strategy, risk management, and metrics and targets. These reflect the type of information investors express interest in. While there has been a significant growth in disclosure of climate-related metrics, it is also clear that current disclosure falls short of what is required to make a fully informed investment decision. As noted by Peter Damgaard Jensen (PKA CEO) greater disclosure in line with TCFD is "crucial to secure more complete, meaningful, reliable and consistent data across all sectors". This type of data is critical to inform investment strategies. In the report it sets out that "present valuations do not adequately factor in climate-related risks because of insufficient information. As such, long-term investors need adequate information on how organizations are preparing for a lower-carbon economy".

Aligning FTSE Russell's climate change indicators with the TCFD's recommendations

Following the release of the TCFD recommendations in June 2017, FTSE Russell conducted a full review of its climate-related indicators in order to ensure its methodologies and criteria are aligned with the TCFD's recommendations. We have made four major changes:

1. Inclusion of new indicators

We have added seven new indicators (included in table 1). These cover:

- The recognition of climate change as a relevant risk and/or opportunity to the business, and the timeframe over which this is assessed
- How climate-related risks and opportunities are incorporated into strategy (mitigation, new products, R&D, etc.) and capital allocated (OPEX, CAPEX, M&A, debt)
- Whether the company has conducted climate scenario analysis and described the business impacts of one or more climate scenarios
- Exploration and production intensity as measured in greenhouse gas (GHG) emissions per barrel of oil equivalent (for exploration and production, and integrated oil and gas)
- Refining intensity as measured in GHG emissions per barrel of oil equivalent (for refineries and integrated oil and gas)
- Cement production GHG emissions intensity as measured in GHG emissions per ton of cement/cementitious material (for cement)
- Scope 3 emissions (3 years) split by category type

2. New sector-specific indicators

We have also introduced new sector-specific indicators. We now collect data on sector-specific financially material indicators in the following high emitting and high impact sectors: oil and gas, electric utility, cement, real estate, metals and mining, chemicals, steel, food and beverages, paper and forest products, agricultural products, agriculture and investment management (see table 2).

3. Updated sector categorization model

We have updated our sector categorization model (high, medium and low impact) to more accurately reflect the carbon intensity[1] of each subsector. This update has, primarily been based on sector average Scope 1 and Scope 2 emissions, although we have included certain sectors (e.g. oil and gas, coal mining, autos, etc.) where the Scope 3 emissions are significant. We will further refine this

[1] Intensity was calculated by dividing scope 1&2 by the revenue in US$.

model as the quality of Scope 3 data improves, and as our understanding of sector-specific emissions evolves. We also plan on accounting for company-specific information.

4. Increased indicators that assess medium and low exposed sectors

We have increased the number of indicators that we assess for medium and low exposed sectors[2]. Specifically, we have extended the coverage of 3 indicators from high impact sectors to all sectors; these are the independent verification of GHG emissions, the independent verification of energy consumption, and emissions intensity reduction. We believe all companies should disclose on these matters.

Future recommendations

The enhancement of our climate change research model is an ongoing process. TCFD has been clear that its recommendations will evolve as more organizations report on their climate change-related strategies and performance. TCFD has also noted that further work is required in specific areas, notably in the metrics used for assessing performance (a particular issue for the finance sector) and in the assumptions and methodologies used in scenario analysis (which is an issue for all sectors). Given the rapid change in the climate change landscape, we expect that we will formally review our climate change indicators annually for at least the next two years.

Table 1. Examples of FTSE Russell's ESG Ratings indicators which are aligned with the TCFD's recommendations

Governance	Strategy	Risk Management	Metrics and Targets
FTSE Russell's main indicators: • Board oversight of climate change issues	**FTSE Russell's main indicators** • Describe climate change as a relevant risk to the business and discloses time horizon • Impact of climate-related risks on strategy and financial planning • Financial quantification of cost associated with climate change • Climate scenario planning (2 degree and others) and the business impacts	**FTSE Russell's main indicators:** • Climate-related risk management procedures • Adaptation and mitigation of climate-related risks	**FTSE Russell's main indicators:** • Internal carbon price • Scope1,2,3 • Energy consumption • Emissions reduction targets • More than 20 sector specific metrics

Source: FTSE Russell

[2] Exposure is based on the materiality of climate change to the specific subsector the company operates in. A greater number of indicators are applied to companies which have higher exposure.

Table 2. FTSE Russell's sector specific climate-related material indicators (sample)

Indicator description	Subsectors
Disclosure of Oil & Gas Reserves by type (i.e. Proven, Probable and Possible Reserves) Total Oil Reserves Total Gas Reserves Ratio of Oil:Gas Oil & Gas: barrels of oil equivalent of reserves	533 E&P 537 integrated O&G
E&P intensity: GHG emissions per barrel of oil equivalent (CO_2e / boe)	533 E&P 537 integrated O&G
Flaring emissions (CO_2e)	533 E&P 537 integrated O&G
GHG emissions per megawatt hour (MWh)	7535 Conventional Electricity
Production capacity by energy type (MW)	7535 Conventional Electricity 7537 Alternative Electricity
Cement production GHG emissions intensity: GHG emissions per tonne of cement/cementitious material (CO_2e / tonne cementitious or cement)	2353 Building Materials & Fixtures
Disclosure of fleet fuel efficiency data by the following countries/regions: USA; Japan; China – imports; China – domestic production; India; Brazil; Russia; EU; Other; Total	3353 Automobiles
Mining extraction intensity (CO_2e per tonne of ore)	1771 Coal 1775 General Mining
Production intensity (CO_2e per litre product)	3533 Brewers 3537 Soft Drinks
Land to agricultural land conversion rate	3573 Farming & Fishing

Source: FTSE Russell

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