

Inspired thinking



## Do climate change disclosures meet investors' needs?

### Introduction

With the entry into force of the Kyoto Protocol in February 2005 and the introduction of the European Union Emissions Trading Scheme (EU ETS) in January 2005, climate change is increasingly recognised as a key strategic issue for the electricity generation sector. From mid-2005 to early 2006, Insight conducted a detailed review of the manner in which European electricity utilities are positioning themselves to respond to the business risks and opportunities presented by climate change. The aim of our review was to determine the implications of climate change policy for our investments in companies in this sector.

### Key findings

One of the key findings from our analysis was that, despite the significant time and effort invested by many electricity utilities in reporting on their climate-change-related policies and performance, this disclosure is often inconsistent and incomplete. The consequence is that it is difficult to properly assess the risks and opportunities posed by climate change policy and emissions trading to individual companies, and to understand the manner in which the different companies have structured their business strategies and capital expenditure plans to respond to climate change.

In June 2006, Insight published a report entitled 'The Climate Change Disclosures of European Electricity Utilities' that sets out Insight's expectations of European utilities with respect to reporting on climate change and highlighted examples of good practice. Our aim in publishing the report was to ensure

that the time and effort companies spend on climate change reporting actually delivers what investors need. Below, we summarise the report's key recommendations to companies.

### Overview of investors' needs

In order to properly assess the climate-change-related risks and opportunities faced by individual electricity utilities, investors require information on each company's:

- Climate change policies, governance and management.
- Operations.
- Emissions inventories.
- Allocations and emissions management strategies.

### Climate change policies, governance and management

Electricity utilities should publish a clear policy on climate change, explaining how the company prioritises climate change in relation to its other business issues. The policy should recognise the scientific evidence regarding climate change and the contribution of fossil fuel combustion to climate change, and should include commitments to emissions reductions and energy efficiency as well as a statement of the company's commitment to supporting government efforts to reduce greenhouse gas emissions.

This policy should be accompanied by a supporting statement that analyses the risks and opportunities posed by climate change to the company's business, including an assessment of the likely evolution of climate change policy in each of the countries in which the company operates and the financial and

strategic implications of national and international climate change policy initiatives. In the specific context of operations within the European Union (EU), the statement should explicitly discuss the company's view of the likely future price of carbon dioxide (CO<sup>2</sup>) allowances and the number of CO<sup>2</sup> emissions allowances that it expects to be allocated under the EU Emissions Trading Scheme.

Companies should describe the governance and management systems in place to ensure that they respond effectively to the risks and opportunities presented by climate change. Specifically, companies should disclose who, at the board and operational levels, is responsible for the company's climate change strategy. Companies should also disclose their greenhouse gas emission targets and the baseline against which progress towards these targets is being measured.

## Operations

Companies should provide a detailed description of their currently installed capacity (MW) and generating output (GWh), broken down by country and by fuel type. In addition, companies should provide at least five years of projections of their generating portfolios, broken down on a country-by-country basis, that account for all expected changes, including (but not limited to) new investments, efficiency improvements and mothballing and/or decommissioning of plants, as well as information on the capital expenditures associated with new investments.

The plan should be supported by information on expected load factors (for existing and new plant), expected completion dates for new facilities or the decommissioning of existing facilities, and the identification of possible changes in strategy (e.g. if certain investments are not yet confirmed) or other uncertainties.

## Emissions inventories

While the Kyoto Protocol covers six greenhouse gases, the most important by far for electricity generating utilities is CO<sup>2</sup>. Electricity utilities should publish detailed CO<sup>2</sup> emissions inventories that cover historic (at least five years worth of historic data), current and projected future (at least five years worth of data) emissions.

Companies should report their CO<sup>2</sup> emissions data in both specific terms (tonnes of CO<sup>2</sup> per GWh) and in absolute terms (total tonnes of CO<sup>2</sup>). These data should be disaggregated on a country-by-country basis. Companies should also provide explanations for any changes in their emissions profiles (e.g. the installation of new generating capacity, the decommissioning of old plant, specific conditions that affected greenhouse gas emissions such as plant outages or unusual weather conditions).

Companies should disclose the methodology they have used to calculate their CO<sup>2</sup> emissions. If this methodology is not The Greenhouse Gas Protocol (the reporting and accounting standard developed by the World Resources Institute and the World Business Council for Sustainable Development), the company should provide a detailed explanation of the methodology used and should explain how the calculated emissions differ from those that would be obtained by utilising the Protocol's methodology.

Finally, companies should disclose whether a third party auditor has verified their CO<sup>2</sup> emissions inventories and should provide a verification statement that describes the scope and findings of the verification process. If companies have not had a third party verify their emissions inventories, they should provide a detailed explanation of how they ensure the accuracy of their calculations.

## Allocations and emissions management strategies

Companies should disclose the number of CO<sup>2</sup> emissions allowances (also known as European Allowances or EUAs) they received for Phase I of the EU ETS for each of EU countries in which they operate and should also provide this information for Phase II (2008-2012) when this information becomes available.

If companies operate in countries outside of the EU, they should describe their expectations regarding the future policy measures that will be adopted to reduce greenhouse gas emissions from the electricity industry and the company's likely exposure to these policy measures. This should include discussion of expected CO<sup>2</sup> emission allocations or the emission reduction targets that are likely to be required.

Companies should describe the actions that they have taken to abate and/or offset their CO<sup>2</sup> emissions globally, as well as the actions that they plan to take in the future. These actions could include (but are not limited to) actions such as the purchase and/or development of renewable energy sources, fuel switching, installing new generating capacity, emissions trading, and offsetting CO<sup>2</sup> emissions through Joint Implementation (JI) and/or Clean Development Mechanism (CDM) projects. For each strategy employed, companies should provide a description of the action and should specify the amount of CO<sup>2</sup> abatement or offset expected.

### Next steps

Over the summer, we will send a copy of the report to major UK and European electricity companies together with a request that they move towards reporting in line with our proposals. We will also seek to meet with these companies, both to discuss the specific details of their climate change disclosure and their strategies for responding to climate change.

Finally, while our report focused specifically on the electricity generation sector, our recommendations also apply more generally. We have reviewed disclosures in other sectors that are significantly exposed to climate change policy and/or the physical impacts of climate change and a similar picture emerges: the reported data tend to be incomplete and backward-looking, making it difficult for investors to make meaningful comparisons regarding the climate risk exposure of different companies and sectors. We hope, therefore, that this report will assist companies in sectors other than electricity generation to consider how they might structure their climate change reporting in a manner that maximises its usefulness to investors. As part of our ongoing climate change engagement with companies, the quality of disclosure will be a key part of our discussions.

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