



Climate change disclosure standards and initiatives: have they added value for investors?

Introduction

In recent years, institutional investors have actively encouraged companies to disclose information on the business risks and opportunities related to climate change. Perhaps the most high profile investor initiative has been the Carbon Disclosure Project (CDP), now supported by 225 institutional investors, with more than US\$31 trillion in assets under management. Institutional investors have also contributed to the Global Reporting Initiative (which nearly 1,000 organisations in over 60 countries currently use as the basis for their environmental and social reporting) and in May 2005, 14 leading investors and other organisations worldwide launched a new effort to improve corporate disclosure of the risks and opportunities posed by global climate change — the Climate Risk Disclosure Initiative.

These initiatives, particularly the CDP, have played an important role in raising the awareness of climate change as a business issue and have contributed to increased corporate reporting on climate change risks and opportunities. Yet it has become increasingly clear that companies are not providing the information required to allow investors to properly assess the financial implications of climate change.

Insight's new report

In September 2006, Insight released a report, "Climate Change Disclosure Standards and Initiatives: Have they added value for investors?", that sets out our views of the various investor disclosure initiatives. The report concludes that there is a need to substantially rethink the manner in which investors encourage companies to improve their disclosures on climate change, to ensure that such reporting provides what investors need to make their investment decisions.

Box 1: Insight's involvement with investor disclosure initiatives

Insight has played an active role in supporting collaborative efforts to improve the quality of corporate disclosures on climate change, and on social and environmental issues more generally.

Specifically we have:

- Been a signatory to the Carbon Disclosure Project (CDP) since its inception in 2000.
- Been a member of the advisory committee for the development of the Global Reporting Initiative's

- (GRI's) G3 reporting guidelines and we are presently a member of the multi-stakeholder working group developing a pilot version of a GRI sector supplement for the energy utilities sector
- Provided comments, through the Institutional Investors Group on Climate Change (IIGCC), on drafts of the forthcoming Global Framework for Climate Risk Disclosure produced by the Carbon Risk Disclosure Initiative.

Box 2: The disclosure standards and initiatives

The Carbon Disclosure Project

The Carbon Disclosure Project (CDP) was launched in 2000. Its stated aims are to inform investors about the risks and opportunities presented by climate change and to inform companies about shareholders' concerns regarding the impact of climate change issues on company valuations. In order to deliver on these aims, CDP solicits, on behalf of institutional investors, climate change-related information from some of the world's largest listed companies. Since its launch, CDP has sent out four questionnaires. The first three (CDP1 in 2002, CDP2 in 2003, and CDP3 in 2005) were sent to the 500 largest companies in the world, based on market capitalisation – the Fortune 500. The fourth questionnaire (CDP4) was sent in February 2006 to approximately 1,900 companies including those in the Fortune 500, the S&P500 and the FTSE 100, as well as, amongst others, 300 of the largest electric utilities globally and other significant greenhouse gas emitters. Companies' responses are made available through the CDP website. In addition, for each iteration of the questionnaire, CDP has published a report analysing the information obtained. The CDP4 report was released in September 2006.

The Global Reporting Initiative

The Global Reporting Initiative's (GRI's) mission is to make sustainability (economic, environmental and social) reporting by companies and other organisations as routine as financial reporting through the creation of a voluntary, globally applicable reporting framework. The aim is to ensure that such reporting is as consistent as possible across organisations, thereby facilitating comparison between reporting organisations.

The GRI Sustainability Reporting Guidelines 2002 – the central product of the GRI – outline the core content for reporting that is broadly relevant to all organisations regardless of size, sector or location. The environmental performance section of the Guidelines includes several climate change and energy-related indicators. The Guidelines are presently under review with the 'third generation' of GRI Guidelines (G3) and are scheduled for release in October 2006. One of the features of G3 is that it strengthens the 'vision and strategy' section of the Guidelines by requiring companies to disclose information about the impact of sustainability trends, risks and opportunities on the prospects of the organisation.

The Global Framework for Climate Risk Disclosure

The Climate Risk Disclosure Initiative (CRDI) was launched at the May 2005 Institutional Investor Summit on Climate Risk at the United Nations. The CRDI has resulted in the preparation of a Global Framework for Climate Risk Disclosure, which aims to provide standardised guidance on what attributes characterise successful corporate climate risk disclosures. The aim is to encourage companies to provide information on climate change risks and opportunities in a standardised manner that will allow investors to analyse this data and compare companies. The Framework is scheduled for release later in 2006.

The Framework is expected to encourage companies to provide: details of their historic and projected direct and indirect greenhouse gas emissions; a strategic analysis of climate risk and emissions management; an assessment of the physical impact of climate change on their business and an analysis of risk related to the regulation of greenhouse gas emissions.

Insight's views on the value of climate change disclosure initiatives

While these disclosure initiatives have played an important role in stimulating interest in climate change and in setting out some broad parameters for corporate climate change disclosures, our experience is that corporate reporting on climate emissions, strategy and risk management still does not properly meet investors' needs, for the reasons we discuss below.

Backward-looking data

First of all, the focus of reporting has been on historic rather than future performance. While CDP and GRI have each started to request forward-looking information on corporate strategy, neither explicitly request information on expected future greenhouse gas emissions.

Poor quality data

Secondly, the quality and presentation of reported data is poor. For example, just 48% of the surveyed companies in CDP4 disclosed emissions data. Further, companies do not follow a single disclosure standard (although all three of the disclosure initiatives state that the World Business Council for Sustainable Development's (WBCSD's) Greenhouse Gas Protocol is the preferred framework for reporting). Companies also tend to treat reporting boundaries inconsistently with many, for example, not stating explicitly what is included or excluded from the scope of their report. The reported data is also rarely audited.

Confusion reigns

Thirdly, the multiplicity of initiatives risks creating confusion for companies and investors. While the CDP and the proposed Global Framework on Carbon Risk Disclosure seem *prima facie* to be directed to the same end (i.e. specifying the information that investors require from companies), the two initiatives are not consistent in the information they request from companies. Moreover, the GRI is probably not the best means by which to generate the data required

by investors because it exists to identify information desired by a range of stakeholders, rather than investors specifically. Many other stakeholders are pressing for disclosure of data that they find relevant, but that is not material to investment decisions. There is a very real risk that the multiplicity of initiatives will have the effect of lowering, rather than raising, the quality of corporate disclosure by creating confusion about the specific information investors require versus other stakeholders.

Lack of direct engagement with companies

Finally, most investors have not communicated directly and clearly enough how important they believe climate change to be as an investment issue. Many companies appear not to appreciate that a large and increasing number of investors believe that climate change risks and opportunities are material and, therefore, want data that allows them directly to assess the implications for companies. One reason for this seems to be that many investors have not requested the information directly from the companies but have instead delegated responsibility for gathering information to CDP – without realising that it will not generate all the investment-relevant information they need. The feedback we receive from companies indicates that they are sometimes asked by shareholders about whether or not they respond to initiatives such as the CDP, but they are rarely – if ever – challenged about the quality of the information they provide. In addition, even if investors do request climate change statistics, companies do not see evidence of that data being taken into account in investment decisions.

Conclusions and recommendations

Investor disclosure initiatives have made an important contribution to encouraging companies to improve their disclosure on climate change. Yet, individually and collectively, the major investor-backed disclosure initiatives have not delivered the consistent and comprehensive reporting that would allow investors to make meaningful comparisons between companies and to properly analyse climate change-related risks and opportunities.

Perhaps the most important conclusion from our analysis is that investors need to send stronger signals directly to companies to emphasise the importance that they assign to climate change. Specifically, they need to communicate that they expect companies to provide appropriate disclosures on the risks and opportunities presented by climate change and that to have strategies to reduce greenhouse gas emissions and to adapt to the physical impacts of climate change.

It is also important that investors clearly communicate the type of information they require. Specifically, we believe that companies should:

- Provide forward-looking information on greenhouse gas emissions and on the costs of responding both to the physical impact of climate change and to policy measures directed at reducing greenhouse gas emissions.
- Follow the WBCSD's Greenhouse Gas Protocol when preparing their reports on greenhouse gas emissions.
- Set reporting boundaries that properly capture all greenhouse gas emissions from their operations and activities.
- Assure their climate change-related data in a similar manner as their corporate financial information.

To view this report see http://www.insightinvestment.com/global/documents/riliterature/367922/cc_disclosureinitatives_report.

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Produced by the Insight Investor Responsibility Team

Web: http://www.insightinvestment.com/responsibility/investor_responsibility_home.asp

Tel: 020 7321 1162

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