Radnor View

Green Horizon: shining a light on how to get ESG right

18th November 2020

Last week was a big week for ESG. The Green Horizon Summit in London marked a flurry of announcements about the determination of governments, regulators and the financial services industry to act on climate change and biodiversity loss.

Companies struggling to make sense of the seemingly endless conveyor belt of ESG consultations, guidelines, frameworks and standards may be wondering what difference yet another conference on climate change would have made.

However, Radnor came away from Green Horizon with a far greater sense of clarity around the challenges listed companies will face over the next decade and what is required to remain relevant to the market's evolving needs. A key objective for our clients is to bridge this gap to increasingly ESG-sensitive capital.

In summary, the Green Horizon Summit:

- Fired the starting gun on the critical conversations and initiatives that will hardwire the COP26 objectives into the capital markets
- Clarified the scope of structural and regulatory change that will be needed for markets to allocate capital more effectively to sustainable activities
- Confirmed that mandatory TCFD reporting is now in sight… and that more Task Forces are coming
- Indicated that the regulatory focus would sharpen on science-based targets and metrics for both company and investor disclosures
- Presented the private finance strategy and framework that companies will need to work within on the road to COP26

Companies should also take note of the recommendations from the climate thematic review by the Financial Reporting Council. **This echoes what we heard at Green Horizon about the need for ESG communications and disclosures to be anchored on scientific proof, and aligned with the aims of the Paris Agreement, in order to really resonate with investors.**

Read on for our take on why these themes matter for companies attempting to navigate and make sense of this complex ESG landscape.

COP26: bigger than COP21

Monday, 9th November 2020 should have marked the start of COP26 – shorthand (mercifully) for the 26th Annual Session of the Conference of the Parties to the United Nations Framework Convention on Climate Change (UNFCCC). When it happens, COP26 should be a pivotal moment; when nations meet after 5 years to review and strengthen the commitments set by the Paris Agreement (struck after COP21 in December 2015).

> The central aim of the 2015 Paris Agreement is to limit global temperature rises this century to 'well below' 2°C above pre-industrial levels – and preferably closer to 1.5°C.
>
> More importantly for us all, COP26 will reveal more about the scale of the job left to do, if 2020 is not be remembered as one of the coldest years for the rest of the 21st Century.

The coronavirus pandemic has unravelled many things this year, not least forcing the delay of COP26 for 12 months. However, the pandemic has shown the scale of societal disruption needed to rein in annual global greenhouse gas (GHG) emissions by c.8%, the widely agreed level required annually to halve GHG emissions by 2030 and keep the planet on track to warm by less than 2°C by 2050.

Given such a stark reality, it is clear that world policymakers need to remain committed to the urgency and scale of action that a lasting green recovery will require.

Green Horizon provided precisely that clarity.

Green Horizon: a key staging post on the road to COP26

Green Horizon brought together an impressive cast of state and industry leaders, policymakers and regulators, which gave business and investment communities a deeper understanding of the evolving objectives and actions that governments and regulators will need to undertake to combat climate change.

While there is a lot of detail that will need to be worked through, the new consultations and initiatives will ultimately inform both companies and investors what carrots and sticks are likely to emerge from COP26 in a year's time, and how the relationships between companies and capital will be transformed as a result.

We would highlight four themes (see below) from Green Horizon to help guide corporate thinking on ESG priorities. These will ensure that the scope, objectives and proof points for an effective ESG strategy can be robust in this fast-evolving capital markets environment.

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1. Markets still need substantial rewiring in order to allocate capital effectively to sustainable activities

Ten key actions were outlined at Green Horizon. These speak to the degree of systemic change that will be needed to redirect capital to its most sustainable uses:

<u>Key actions for a green recovery</u>

1. **Investment in sustainable infrastructure and project financing** that diverts capital currently invested elsewhere
2. **Establish functioning global markets for natural capital and carbon offsets,** enabling rewards for negative emissions
3. **Scale up emerging technologies that support sustainability** and the advisory support needed to access capital markets more quickly
4. **Advance the adoption of common metrics, global standards and reliable data** to allow more uniformed benchmarking and informed assessments of sustainability compliance and opportunities for improvement
5. **Provide more sustainable development finance capital** to small to medium enterprises
6. **Build nature-based solutions and carbon capture use and storage into companies' asset base and supply chains**
7. **Start accounting for natural capital on companies' balance sheets,** to put nature and sustainability at the centre of companies' business models
8. **Reimagine industries through the lens of sustainable markets,** to create more resilient and sustainable products, services and supply chains
9. **Make sustainable options the trusted and attainable options for consumers.** With consumers controlling an c.60% of global GDP, people will drive the transformation to sustainable markets
10. **End fossil fuel subsidies and improve incentives for sustainable alternatives**, levelling the playing field for access to capital

These actions contextualise what challenges – but also opportunities – companies need to embrace to be part of a sustainable future.

Corporate accountability for the depletion of natural capital on corporate balance sheets, for example – without which firms cannot comment on the true systemic value of their asset base, nor how damaging their operations may be on the natural world – is an imperative to which the global accounting profession is already alert.

An IFRS Foundation consultation is currently underway (link here), which provides some early indications of how sustainability reporting may be wrapped into financial accounting and reporting practices. The scale of UK government and supervisory support for the IFRS Foundation's proposal to establish a Sustainability Standards Board is already clear from a joint statement (link here) last week by the FCA, Bank of England, FRC, the Pensions Regulator, BEIS, DWP and HM Treasury.

2. Mandatory TCFD reporting is now in sight… and more Task Forces are coming

The success of the TCFD in distilling the essential elements of corporate thinking, behaviour and reporting on climate risks has been rewarded by widespread adoption of the TCFD Framework by market participants. Green Horizon signalled the intent of the UK Government, Bank of England and Financial Conduct Authority to embed the TCFD's recommendations in the regulatory landscape.

Most notable for corporates is that the FCA announced (link here) that new rules would be introduced from **January 2021** requiring premium listed companies to make better climate risk disclosures, consistent with the TCFD. The FCA's final rules will follow by the end of this year. The FCA will also consult in the first half of 2021 on extending the scope of these rules and also on introducing TCFD obligations for asset managers, life insurers and pension providers.

Companies should note that the success of TCFD has spawned two new Task Forces, both of which were evident at Green Horizon and summarised in the boxes below.

The Task Force on Climate-Related Financial Disclosures (TCFD) was created in 2015 by the Financial Stability Board out of the need to harmonise a fragmented landscape of guidance, standards and other approaches to climate and sustainability reporting. If you think that today's ESG landscape is crowded and confusing, bear in mind that there were over 400 sustainability initiatives in play before TCFD grasped the nettle.

The TCFD's recommendations (link here) constitute a best practice blueprint for how companies should organise their leadership, strategy, risk management and communications to produce decision-useful, forward-looking information that can help stakeholders understand the financial impacts of climate-related risks.

As of September 2020, nearly 1,500 organizations globally support the TCFD, spanning companies with a combined market capitalisation approaching $13 trillion and nearly 700 financial firms responsible for assets of $150 trillion.

TNFD

Biodiversity loss is clearly going to be the next battleground and is likely to gain equal status with climate change as a sustainable finance theme.

Given that climate change and the coronavirus pandemic have common roots in the loss of natural habitats to human activity, **Radnor recommends that companies keep an eye on the progress of the Task Force for Nature-related Financial Disclosures (TNFD)** (link here).

Established by the United Nations, next year's conference of the UN Convention on Biological Diversity (not to be confused with the UNFCCC) could empower the TNFD to mirror the success of TCFD with a framework that connects nature-related risks with corporate activity. Such a development would expand investor mandates and steer more capital to nature-positive projects and strategies.

TSVCM

At Green Horizon, Mark Carney also announced the publication of initial recommendations from the Taskforce on Scaling Voluntary Carbon Markets (TSVCM) (link here). The development of a global market for pricing carbon is widely regarded as the gamechanger needed to address the environmental challenges of pricing the costs of carbon-based economic activity. The aim of the consultation is to create a new market to finance investments for net zero and nature, as well as send a positive signal to nature-based project developers and carbon capture innovations via carbon credits.

With mandatory TCFD reporting now within sight, Radnor Capital is helping companies sharpen interactions with ESG-sensitive investors. While TNFD and TSVCM are likely to further broaden the scope of risks and responsibilities on boardroom agendas, and the complexity of financial reporting and disclosure as a result, Radnor Capital is ideally positioned to help our clients put their best foot forward.

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3. A financing roadmap for a whole economy transition to Net Zero

Paris Agreement objectives will ultimately require whole economy transitions, with every company, bank, insurer and investor aligning their business models to ensure that every financial decision takes climate change into account. To address this aim, Mark Carney announced a private finance strategy for COP26: Building A Private Finance System For Net Zero (link here).

Framed around the four pillars of – 'Reporting', 'Risk Management', 'Returns' and 'Private Capital Mobilisation' – the Bank of England's summary of the key elements and objectives of each pillar (link here) is a helpful starting point. This suggests where debate, collaboration and efforts are likely to be focused over the year ahead.

The key takeaway for companies? If proof of alignment with national Net Zero goals and timelines is not already baked into corporate ESG strategies and communications, it will soon need to be.

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4. Regulatory focus is set to sharpen around common, forward-looking science-based targets and metrics

Another notable development was the release of a consultation by the TCFD Portfolio Alignment Team (link here) to explore how to achieve better alignment of investment portfolios, and the companies they invest in, with national Net Zero ambitions and commitments.

The consultation notes that while the methods for measuring portfolio alignment with the Paris Agreement are new and still evolving, fundamentally any company or portfolio on the transition path should have a strategy consistent with the Net Zero targets and timelines of the countries they are exposed to and operate in.

While the consultation is aimed primarily at investors and lenders, the corollary is that company ESG strategies, climate risk scenarios, targets and metrics will need to align with those of investors and lenders in order for ESG-sensitive capital to be allocated to them.

Radnor Capital can inform companies of the choices they need to make to fit with the proposed metrics that would correlate company and portfolio alignment with the Paris Agreement objectives.

The Financial Reporting Council – a thematic review for boards, companies, auditors, professional bodies and investors

As if everything on the climate action to-do list at Green Horizon was not enough, the Financial Reporting Council separately weighed in with a major announcement concerning non-financial reporting frameworks (link here). This concluded that boards and companies, auditors, professional associations and regulators all need to do more.

This is certainly consistent with the calls to action in the Green Horizon Summit, and to be fair the FRC has been thorough in its recommendations (link here) of what 'more' should look like. More on that in a future Radnor View, but suffice to say that we note the FRC is taking a consistent line with regulators and governments in recommending the specific ESG framework and reporting standard that companies should voluntarily adopt **within their next reporting cycle.**

Get in touch if you would like our insights and advice on how the key themes from the Green Horizon Summit and the FRC's climate thematic review will impact companies.

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