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TCFD and Beyond: **Preparing the Board and the Business to Support Mandatory ESG Reporting**

How legal and governance teams can lead the drive for ESG reporting readiness

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TCFD and Beyond:

Preparing the Board and the Business to Support Mandatory ESG Reporting

The urgent need to address the climate emergency and implement accountability for the social impacts of business activities has led to the emergence of a range of ESG-focused reporting frameworks, guidelines and standards.

The most prominent of these is arguably the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), a framework designed to promote more transparency around the reporting of climate-related risk, to better inform markets on climate change impacts and enable the mitigation of the financial risks these pose to the global economy. The TCFD recommendations have been voluntarily adopted by a considerable number of major corporations worldwide and UK Chancellor Rishi Sunak announced at COP26 that large UK companies are required to report in line with TCFD from April 2022.

In the US, the Securities and Exchange Commission has passed a proposal to include climate disclosure requirements along similar lines to those of the TCFD. The proposal has undergone a public comment period and, even if it is rejected this time around, its existence is a strong indication of the direction of travel.

A recent Diligent webinar, held in partnership with the Legal 500, convened an experienced panel to discuss what the implementation of TCFD and other ESG-related disclosure frameworks means for boards and businesses. This eBook explores the issues and how legal and governance teams can support the organisation as it prepares for mandatory reporting.

Our ESG experts:

Adrian Fleming

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Natalie Salunke

Head of Legal, RVU

Anthony Kenny

Assistant General Counsel for Corporate, GSK

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TCFD: what it is and why it is different

The Task Force on Climate-related Financial Disclosures was established by the international Financial Stability Board (FSB) in 2015. Its 31 members, drawn from G20 nations, made their first recommendations in 2017. Since then, the task force has reported annually on progress, with the 2021 report noting that voluntary adoption of the recommendations has risen 9% year on year, with more than 2600 organisations now having expressed support.

TCFD differs from other reporting frameworks in that it is fully focused on climate change and specifically designed to be implemented alongside mainstream financial filings. This is about putting climate risk management on a par with financial management and applying similar parameters, ensuring visibility and transparency to the same degree.

UK government's decision to mandate TCFD reporting moves the initiative from the realm of a guidance framework towards more of a standard (see distinctions outlined to the right). With more governments moving to endorse the framework this is likely to become the norm in many nations.

Despite this move towards mandatory TCFD reporting, many organisations are still in the early stages of engagement, and understanding of the requirements of TCFD is limited. In our poll of webinar attendees, more than one-third said they had little understanding of the framework and its requirements. A further 29% said they had some understanding. Only 5% were confident that they had extensive understanding of what it would mean for their organisation.

The immediacy of TCFD mandatory reporting means that boards, legal departments, and governance teams must rapidly familiarise themselves with the framework. The signs are that it will be a steep learning curve for many.

Frameworks, standards and reporting initiatives – what's the difference?

Many organisations are feeling lost among the plethora of different ESG-related data-sharing mechanisms. Diligent's VP ESG & Sustainability, Adrian Fleming, offers this clarification:

Frameworks: guidelines and recommendations on how best to approach reporting ESG impacts. Examples include the TCFD recommendations, the Global Reporting Initiative (GRI), and the UN Sustainable Development Goals (SDGs).

Standards: more prescriptive on how and what organisations should report and often broken down to sector-specific requirements. Examples include the Sustainability Accounting Standards Board (SASB) and the Greenhouse Gas Protocol, that provides a solid grounding on how to calculate GHG emissions for an organisation.

Reporting Initiatives: based on quantitative and qualitative questionnaires around ESG issues. Examples include the CDP (formerly the Carbon Disclosure Project), Dow Jones Sustainability Index (DJSI) and industry-specific initiatives such as GRESB in the construction sector.

How would you rate your understanding of the Task Force on Climate-Related Financial Disclosures (TCFD) and its requirements?

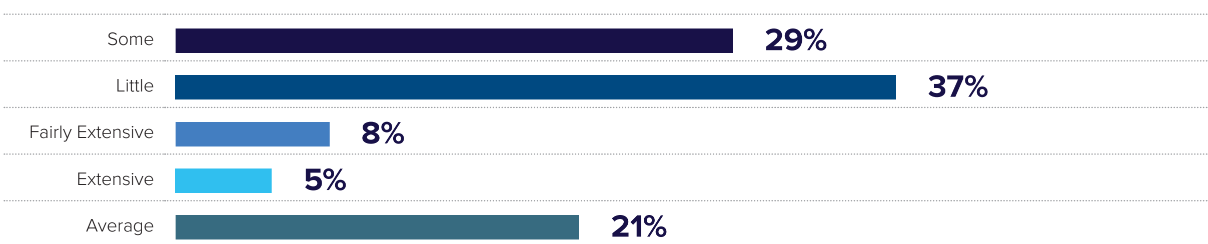

Figure 1: Understanding of the TCFD and its requirements

The Four Pillars of the TCFD

The 11 core recommendations in the framework are based on four main pillars:

Strategy:
the actual or potential impacts of climate-related risk on the organisation's businesses, strategy and financial planning

Governance:
board oversight and executive management handling of climate-related risks and opportunities

Risk:
how the organisations identifies, assesses and manages climate-related risk

Targets and Metrics:
the metrics and targets used to assess and manage climate-related risk

These pillars prompt organisations to consider the strategy and systems they must implement to meet the framework's requirements and embed climate change considerations into business as usual. They also ensure that there are roles and responsibilities at board level to maintain effective oversight of climate-related risk.

The first three pillars are accompanied by what Diligent's Vice-President, ESG & Sustainability Adrian Fleming describes as "concise guidance" for organisations. The way the organisation approaches governance, strategy and risk should inform the selection of targets and metrics that are material to the business and crucial to effective and transparent reporting.

However, says Adrian, often businesses find the identification and monitoring of targets and metrics to be the most challenging element. This can lead them to take the reverse approach, looking for manageable metrics and working backwards to build them into strategy, governance and risk structures. This is a less progressive approach and risks limiting the potential for improvement over the long term. Instead, it is advisable to consult the TCFD guidance documents that explain how companies should address governance, strategy and risk requirements and link them to relevant targets.

Part of the anxiety around identifying and monitoring metrics is down to concern over the practicalities of collecting and analysing vast quantities of information from thousands of sources. Setting up a structure to obtain this data is not an easy task and organisations can feel reticent about publishing data they feel is incomplete. However, the TCFD guidance documents contain a comprehensive section on metrics and within this is recognition that assumptions may need to be made[1]. This is an acknowledgement of the reality facing many organisations: it is currently difficult to access underlying source data on areas such as GHG emissions and resource consumption – particularly for scope 3 emissions.

[1] TCFD Guidance on Metrics, Targets and Transition Plans, p. 15
https://assets.bbhub.io/company/sites/60/2021/07/2021-Metrics_Targets_Guidance-1.pdf

33%

say monitoring and reporting on ESG data is the biggest internal challenge they face

This is borne out by the response from our webinar attendees, where the largest proportion (33%) said monitoring and reporting on ESG data was the main internal challenge facing their company (Fig.2). Respondents also felt that consolidating data from across the business is also a significant challenge (24%), indicating that they are aware of the potential pitfalls of reporting redundancy.

There is less concern about aligning goals to a recognised ESG framework, with only one in five saying this is the main challenge. As the TCFD emerges as a frontrunner in ESG reporting frameworks, this offers organisations more clarity on which to base their strategy. Even if further standards are developed, it is likely that they will be based on this initial work by the FSB.

In your opinion, what is the main (internal) ESG challenge facing your company?

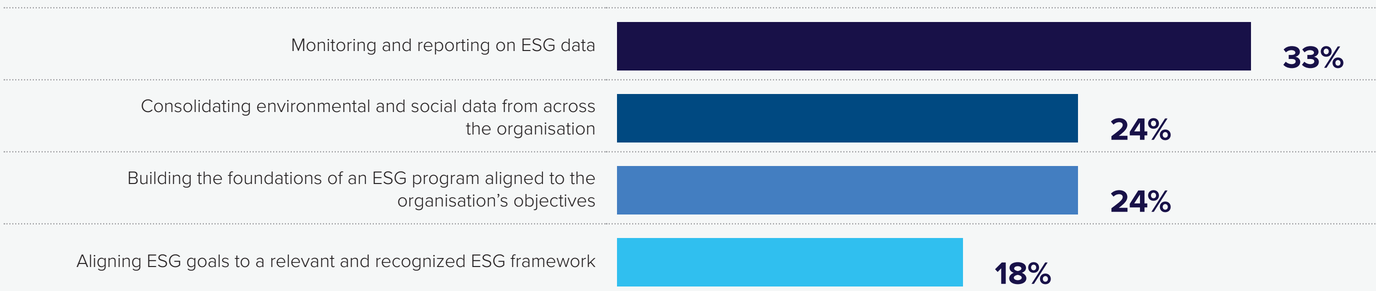

Figure 2: The main (internal) ESG challenge facing companies

Effectively, most organisations are still in the early stages of their journey to full ESG reporting competence, and it can take years to establish a robust infrastructure and processes for data collection, analysis and reporting. However, they have to start somewhere and, by offering flexibility around scenario-based reporting, the TCFD allows organisations to take the first important steps.

> "The main thing is to be transparent. Everyone understands it is very difficult to get this kind of information out in a short period of time. When there is uncertainty around the data that you are disclosing, be clear about what those uncertainties are. Be transparent, if you are making assumptions, clarify what those are and make them public."

Adrian Fleming
VP, ESG and Sustainability, Diligent

Bringing the board on board

Failing to report fully and transparently will become both a compliance and a reputational risk.

The governance pillar of the TCFD makes it clear that organisations should disclose the board's oversight of climate-related risks and opportunities, and describe the role of the executive team in assessing and managing them. Together with increased scrutiny of corporate ESG performance from consumers and investors, this overt direction from the TCFD on the role and responsibilities of boards should be sufficient stimulus for directors to prioritise alignment.

Certainly, all the evidence strongly points to a future where ESG monitoring and reporting attains a level equal to that of traditional financial reporting measures. It will become a comparative tool, allowing evaluation of an organisation's performance against its peer group for the purposes of investor and consumer decision-making.

Failing to report fully and transparently will become both a compliance and a reputational risk – particularly in light of additional regulations requiring companies to assess the sustainability performance of their supply chain. Ultimately, this will affect the company's competitive position and ability to contract with customers.

At board level, the organisation needs to examine whether the board's composition contains sufficient expertise on climate change as it relates to the business and its industry. This is an area that has already seen considerable investor interest, as in the case of ExxonMobil, where activist investors secured the appointment of three directors with experience of the energy transition after a campaign that criticised the lack of skills among incumbent directors.

The board should also consider whether its structures, committees, and decision making processes require amending to incorporate sufficient focus on climate-related risk oversight. Similarly, the division of roles, responsibilities and accountability should be reviewed to ensure they are effective.

Finally, the board will need to consider how it links the achievement of climate-related targets to executive compensation and performance incentives.

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Bringing the business along on the ESG journey: building a culture to support ESG reporting

A further, important role for the board, supported by the governance team, is to set the tone for an organisation that understands and values the activity of ESG reporting. Information collection on the scale needed for TCFD and other reporting requirements is going to be a whole-business exercise. It is vital that the board communicates the importance of the process in terms not only of compliance, but also of the organisation's ability to raise finance, contract with customers, remain competitive and – perhaps most tellingly – align with sustainable values.

> *Natalie Salunke, Head of Legal at RVU, explains the importance of ensuring the ESG reporting process is not just a tick-box exercise: "Ultimately, reporting is a way of getting metrics, but the underlying substance is down to culture and how people behave; the individuals in the organisation and the different [sustainability] things they are doing."*

ENGAGING WITH "BELIEF-DRIVEN EMPLOYEES"

The good news is that many businesses will find they are pushing at an open door when encouraging employees to adopt, monitor and report on sustainable practices – and to appreciate the importance of doing so. The pressures of the pandemic prompted many workers to evaluate the way their workplace aligns with their personal values and has resulted in what the World Economic Forum has termed the "belief-driven employee". The 2021 Edelman Trust Barometer found that 59% of employees changing jobs were doing so in part to find a better fit with their values, while only 31% were looking for better compensation.

Natalie Salunke believes that belief-driven employees can be a considerable asset to an organisation as it builds an ESG reporting culture: "People want to be part of a journey that feels like it is contributing to something bigger. Look at how you harness people's natural passions – how do you actually get people who are passionate about this sort of thing to add more value to your organisation."

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Natalie Salunke
Head of Legal, RVU

MANAGING THE MIDDLE

> ...the communications supporting the ESG reporting drive must position it as more than simply an administrative burden

Directors can set the tone from the top, and belief-driven employees – typically newer hires and early career individuals – may be enthusiastic about supporting ESG reporting. However, it is also important to address what has been termed the "frozen middle" – mid-careerists in middle management roles who have been in post for some time. This cohort faces a particular set of pressures and can be more cynical about data capture initiatives they may feel are imposing on how they have successfully operated to date.

Natalie Salunke proposes treating the challenge like any change management project. This means tackling it in a structured way, getting buy-in by tailoring communications to audiences and finding the right motivating factors for each.

Here, legal and governance teams can play an important role, drawing on the relationships that they have developed at all levels of the company. By talking to different stakeholders, the team can identify where there is existing subject matter expertise, where there is genuine passion and engagement already, and crucially where more resources are needed to enable the level of reporting required.

Crucially, the communications supporting the ESG reporting drive must position it as more than simply an administrative burden, and instead as the mechanism through which the company lives out and demonstrates its beliefs and values.

IN-HOUSE COUNSEL LEADING THE ESG AGENDA

> "I believe strongly that in-house counsel, on all risk, but on this one in particular have got a real role to play here. In-house counsel are stepping up, they are joining organisations such as Lawyers for net-zero and the Association of Corporate Counsel - there's a real energy that we have got to keep building on."
>
> **Anthony Kenny**
> **Assistant General Counsel,** GSK

Anthony Kenny, Assistant General Counsel, GSK, strongly believes that in-house counsel is best-placed to drive ESG initiatives and the related reporting requirements, saying: "Most in-house counsel [...] are very fortunate to have a business-wide view of what is going on from the supply chain through to what is going on in the corporate centre. That gives the in-house legal team an amazing – probably unique – view of the whole business. So, when something like [TCFD] comes along (and other issues like data privacy, all these regulations that can have an impact on the business) we have the ability to see that and translate it into business impact."

The highly developed skill set in in-house teams is also a distinct advantage in projects of this kind, continues Anthony: "Most in-house counsel have developed a risk radar and ability to approach problems through a risk management lens. This is helpful for an environment like this, to look at a regulation and do a risk analysis and apply that risk analysis to the business in a pragmatic, practical and commercial way. What does this mean for us as a business? What processes do we need to change, what data do we need to gather, what are the things we need to think about? So I think there is that much more pragmatic, direct conversation that we would have with the board compared to external colleagues."

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Preparing for mandatory TCFD disclosure: key components for bringing ESG together

There are six core areas that companies must address as they transition towards a mature ESG programme. By assessing the status quo and asking key questions in each area, the business can establish where gaps exist and where investment is required.

1

Leadership

Strong, focused, engaged, proactive.

2

Goals

Meaningful, material, relevant.

3

Frameworks

Mix-and-match across different ESG pillars.

4

Data

Accurate, timely, diverse.

5

Technology

Bespoke, automated, secure.

6

Reporting

Values-based, data-rich, auditable.

01 LEADERSHIP

Strong and focused leadership is essential to driving a successful ESG programme. The board must be informed, engaged and proactive about setting a tone that puts ESG at the heart of the business. This drive must be cascaded through all levels of the business, ensuring that employees, partners and suppliers are equally motivated and incentivised to support the programme.

02 GOALS

ESG targets should flow from company strategy and serve the broader company purpose. While some targets will undoubtedly fall out of the relevant regulatory reporting requirements imposed on the industry, organisations should attempt to avoid reverse-engineering all their goals on the basis of reporting requirements. To ensure that goals are authentic, ensure that they are meaningful, material, and relevant to your industry and stakeholders.

03 FRAMEWORKS

We have focused on the TCFD in this eBook, but it is important to be aware of other frameworks that exist for operationalising ESG and to evaluate their usefulness. TCFD is predominantly climate-focused, but other frameworks focus more tightly on social progress and good governance. Organisations can build a more holistic ESG programme by mixing and matching frameworks and ensuring that they achieve a balance between each of the three pillars of ESG.

04 DATA

Data will power the organisation's tracking, reporting, and collaboration and ultimately inform future ESG strategy, therefore it is vital to identify the right mix of data sources and how to access them. Internal data is largely in the control of the business, but establishing a process for regular reporting can be a challenge. External data, such as peer performance information and market data, can be extremely valuable, but it must be accurate and up to date. It is worth taking time to ensure that you have the right information at your disposal and that you can analyse and manage it effectively and securely.

05 TECHNOLOGY

Wherever large amounts of data must be collected, analysed, and shared, it is logical to use technology, yet a surprisingly high percentage (61%) of respondents to a Diligent/OCEG survey said they don't use software that specifically supports ESG data collection. Using disparate tools that don't integrate well together can lead to data siloes, inefficiency, and inaccuracy resulting from copy/paste errors. A technology solution that supports the automated collection and reporting of key goal-related data helps businesses better understand progress and develop future strategies.

06 REPORTING

Reporting is the public-facing outcome of all the hard work that goes into an ESG programme and it should flow seamlessly from every area of activity. It must be a balance of values-based narrative and robust data points that provide evidence of achievement and progress towards the stated outcomes. As the programme evolves, the reporting system must be able to track changes throughout to deliver auditable oversight. Again, a technology solution that supports this, using dashboards and data visualisation, can do a lot of the heavy lifting for the governance and reporting teams.

Learn more about how to prepare for mandatory ESG reporting in our comprehensive white paper.

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Diligent ESG for mandatory reporting

When you need the tools to help your business demonstrate and integrate its ESG values and build an effective reporting programme, Diligent's ESG solutions provide the structure, assurance and seamless access to data you need.

Supporting TCFD since 2017, Diligent ESG allows organisations to map data against a variety of standards including SASB, GRI, CDP and WEF. Users can easily pull data from systems of record, surveys, and spreadsheets using workflows, reminders and robotic automation, simplifying the process of data collection and lifting administrative burden from departments and teams.

Diligent ESG is a purpose-built platform that collates ESG data from diverse sources to support goal setting, risk monitoring, GHG measurement and stakeholder reporting. It allows teams to:

- Easily collect, normalise, centralise and report on ESG data
- Track against common standards with reports formatted to comply with ratings agencies and standards including TCFD, DJSI, GRI, CDP and more
- Improve confidence and investor sentiment by enabling fast, accurate responses to data requests
- Reduce reporting redundancy by centralising data collation and eliminating the need to manually enter data into each reporting framework
- Monitor climate data by providing calculations and reports from over 62,000 emission sources with a robust audit trail
- Assess third party risk via the supply and value chains with sophisticated third party risk tracking, including scope 3 GHG emissions.

ABOUT DILIGENT CORPORATION

Diligent is the global leader in modern governance, providing SaaS solutions across governance, risk, compliance and ESG. Serving more than 1 million users from over 25,000 customers around the world, we empower transformational leaders with technology, insights and confidence to drive greater impact and lead with purpose.

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