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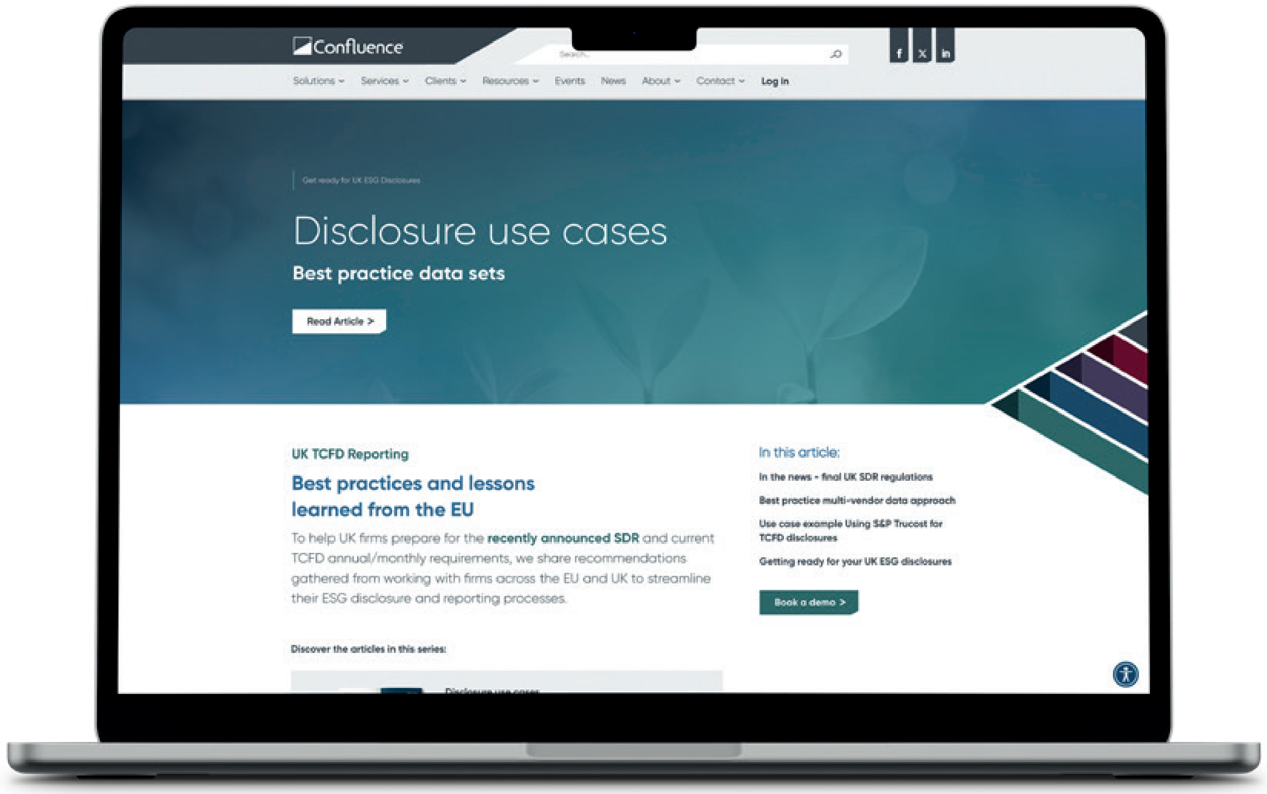
Article

Get ready for UK ESG Disclosures

Disclosure use cases

Best practice data sets



About UK ESG Disclosures Series

To help UK firms prepare for recently announced SDR requirements and current TCFD annual/monthly requirements, we share recommendations gathered from working with firms across the EU and UK to streamline their ESG disclosure and reporting processes.

This three-part series applies lessons learnt from these endeavours, to help firms streamline their operations and reduce regulatory risk of their ESG disclosure requirements.

Learn about:

- **Operations**: Incorporating climate/ESG disclosures into your investment operations
- **ESG data points and models:** Managing ever-changing vendor data and complex modelling requirements
- **Disclosure use cases:** Best practice data sets.

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Disclosure use cases

In **previous articles** in this series, we shared lessons learned from working with firms in the EU to incorporate climate/ESG disclosures into their investment operations. We also looked at how firms can manage evolving vendor data, plus how to navigate complex modelling requirements, with a deep dive into TCFD reporting and an additional climate value at risk (VaR) example.

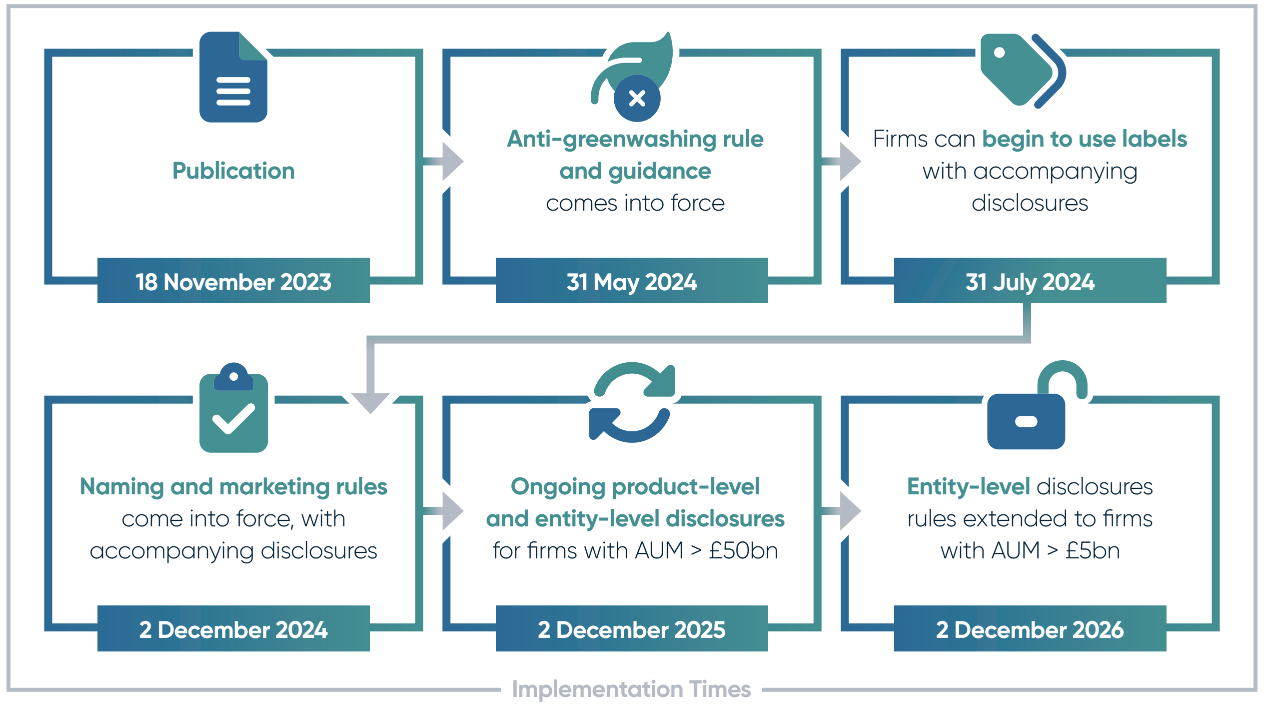
> In this article we give an overview of the new UK SDR regulations and the timeline firms need to adhere to. We also recommend the best practice data sets for each regulatory disclosure use case and deep dive into a TCFD case study, leveraging our **Confluence Revolution ESG solution**.

In the news Final UK SDR regulations

After a long wait, the FCA published the final sustainability disclosure and labelling regime for UK (SDR) on 28 November, 2023. View the full details here.

The FCA has confirmed a substantial package of measures to improve the trust and transparency of sustainable investment products and minimise greenwashing. The first SDR compliance date is 31 May, 2024.

Timeline for firms' staggered obligations



SDR Investment labels

- Sustainability Impact™
- Sustainability Focus™
- Sustainability Improvers™
- Sustainability Mixed Goals™

SDR requirements Summary

Anti-greenwashing rule for all FCA authorised firms to reinforce sustainability-related claims must be fair, clear and not misleading. FCA also consulting on support guidance.

Four labels to help consumers navigate the investment product landscape and enhance consumer trust.

Naming and marketing rules for investment products, to ensure the use of sustainability-related terms is accurate.

Consumer-facing information to provide consumers with better, more accessible information to help understand the key sustainability features of a product.

Detailed information targeted at institutional investors and consumers to help provide additional information for pre-contractual, ongoing product-level and entity-level disclosures.

Requirements for distributors to ensure product-level information (including the labels) is made available to consumers.

Now timelines and final requirements have been confirmed, Confluence's regulatory and technology experts are addressing these in detail to ensure full coverage and compliance from data vendors and risk models to meet the disclosure report formats. Further details of Confluence's support for the final SDR requirements will be announced in the future.

Best practice Multi-vendor data approach

Mapping and maintaining the required disclosure metrics is a complex, time-consuming process. Firms can be challenged with knowing which ESG data vendors to select for the ever-evolving regulations and jurisdictional variations.

ESG data vendors can vary in both quality and coverage and are continuously adjusting their data and data sets. A lack of harmonisation in ESG reporting standards and a lack of a centralised platform for ESG data collection and reporting further complicates matters for firms.

During SFDR regulations rollout we noticed most firms use multiple, sometimes overlapping data vendors and many systematically override vendor data with their own assessments, as they don't trust or agree with the data provided by the vendors.

We recommend working with a specialised ESG reporting technology and risk modelling vendor to remove the manual processes of finding the latest data sets to comply with regulation updates, and to simplify data modelling into a ready-to-use, compliant report. The templated report needs to cover the totality of the portfolio across multiple asset classes, from equities to fixed income, and from mutual funds to derivatives if needed.

Our end-to-end ESG monitoring and reporting tool, **Confluence Revolution ESG solution**, simplifies the identification, management and integration of climate and sustainability risks into a firm's overall risk management and ESG disclosure processes.

Use case data sets

Confluence adopts a client-led, multi-vendor ESG data approach to deliver climate and ESG modelling and disclosures. Through our **Confluence Revolution ESG** solution, we integrate and map data streams to deliver specific ESG data for our clients' individual needs, sourced from industry leading vendors ECPI, S&P Trucost and Morningstar Sustainalytics. Other vendor data sets can also be integrated, depending upon client needs.

We recommend the following ESG data sets for ESG risk management and reporting, TCFS/CAD compliance, EET/PAI/SFDR/SDR compliance use cases:

Use case	Disclosure frequency	ESG risk monitoring calculation frequency	Recommended ESG data set
ESG risk management and monitoring Includes ESG assessment and peer group analysis	Annual or according to internal compliance needs	Any frequency from daily	ECPI + S&P Trucost or M* Sustainalytics
TCFD/CAD compliant Confluence format	Monthly, quarterly, annual Through Confluence Revolution ESG solution TCFD Rev-I report	On demand report *as of date*	ECPI + S&P Trucost
EET/PAI/SFDR/SDR compliant Standardised regulatory format	Monthly, quarterly, annual Through Confluence Revolution ESG solution PAI/SFDR/SDR Rev-I reports or bulk exports	On demand report *as of date*	ECPI + S&P Trucost or M* Sustainalytics or MSCI

Data standardisation across providers

A lack of harmonisation and centralisation of ESG data standards is a challenge for firms. Standardisation across markets, insufficient coverage and inconsistency of data and methods across providers poses significant complications for firms to manage.

Using dedicated data managers Confluence simplifies and streamlines data from each vendor we work with to ensure standardisation across markets and full coverage to help firms meet their ongoing regulatory needs through:

- Standardised integration
- Mapping, cleansing and transformation across asset classes
- Modelling new sets of analytics to meet the ever-evolving regulatory requirements and ongoing data updates provided by vendors
- Data extractions and reporting tools to define and generate reports and disclosure templates for internal and external audiences.

Use case example Using S&P Trucost for TCFD disclosures

To support TCFD disclosures Confluence uses a combination of our own ECPI indices and metrics/modelling derived from data provided by S&P Trucost.

Confluence partners with S&P Trucost to map and maintain data to support all core metrics categories defined within the TCFD framework. Core TCFD metrics and categories are in-built for ESG risk assessment and reporting templates into the Confluence Revolution ESG solution. Using this end-to-end ESG monitoring and reporting tool, firms can access carbon performance, exposure to fossil fuels, power generation across renewable and non-renewable sources, green taxonomy disclosures, net-zero alignment according to various temperature pathways, scenario analysis based on physical risks monitoring across different severities, among other variables.

The screenshots below demonstrate the key categories:

Carbon performance, including Scope 1-3 Greenhouse Gas (GHG) emissions, carbon footprint and carbon intensity

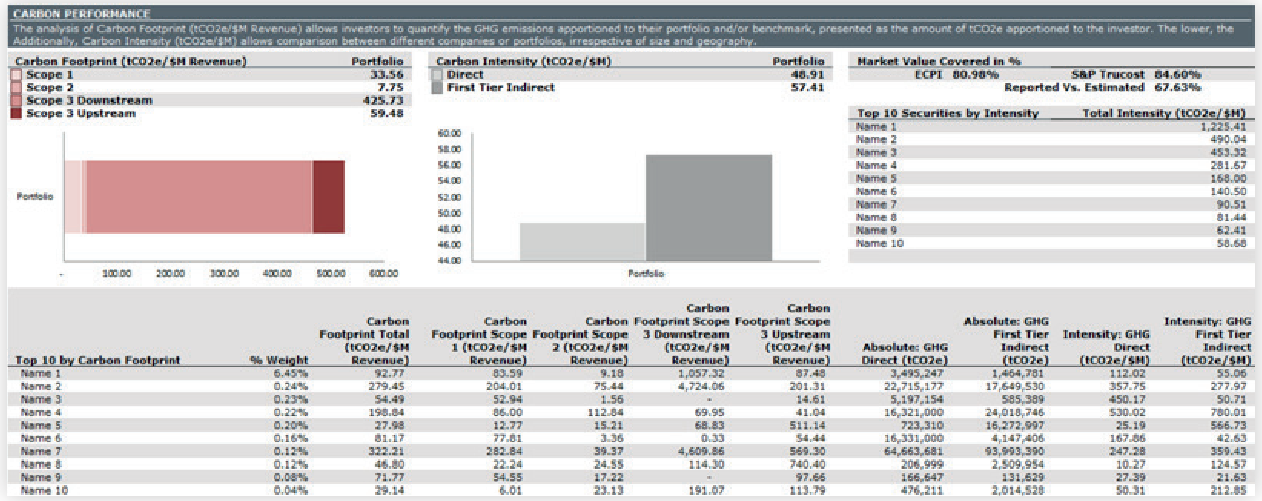


Figure 1: Carbon Performance, Confluence Revolution ESG

Exposure to fossil fuels and breakdown of power generation across renewable and non-renewable sources

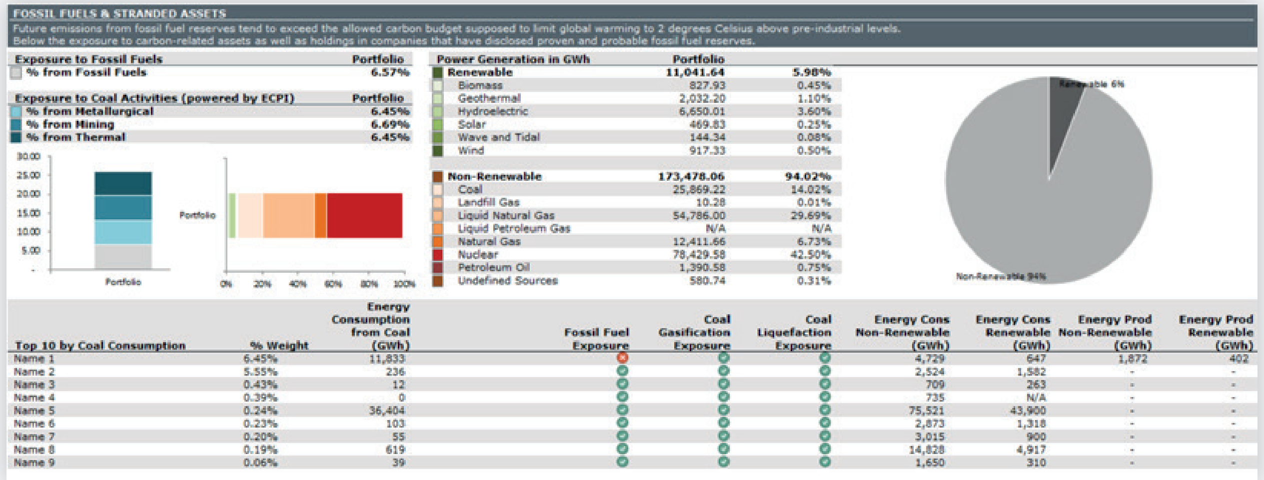


Figure 2: Fossil Fuels & Stranded Assets, Confluence Revolution ESG

Green taxonomy disclosures

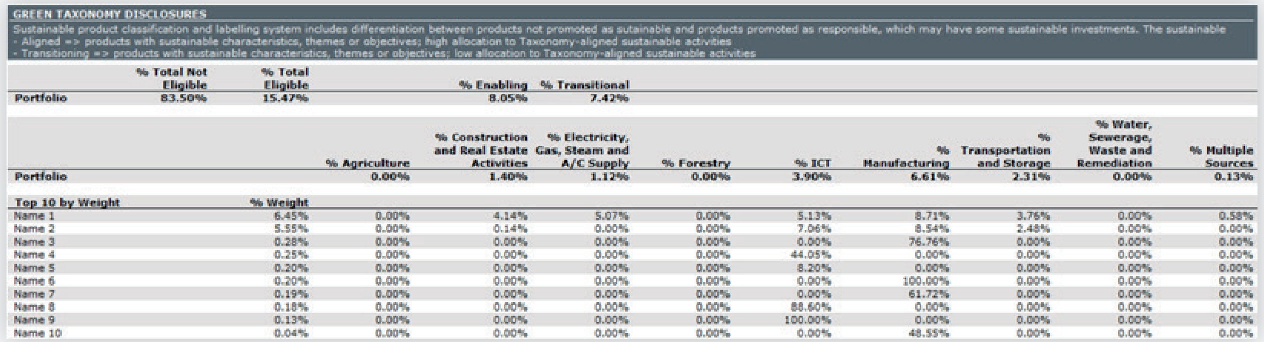


Figure 3: Green Taxonomy Disclosures, Confluence Revolution ESG

Net-zero alignment, according to various temperature pathways

TOWARDS NET-ZERO

The international Paris Agreement on climate change mentions 3 long-term goals: the first two focus on climate mitigation and adaptation, while the third is "to make all financial flows consistent with a pathway towards low-emissions, development.". This recognizes the key role that financial institutions play in realizing the Paris Climate Agreement - including the need to achieve net-zero emissions by mid-century and reduce emissions 50% by 2030.
An Implied Net Temperature can be also derived. Different methodologies apply according to the sector or industry each issuer operates:
- GEVA => the greenhouse Gas Emissions per unit of Value Added equates a carbon budget to total GDP and a company's share of emissions is determined by its gross profit
- SDA => the Sectoral Decarbonization Approach translates greenhouse gas emissions targets into benchmarks against which the performance of individual companies can be compared.

	2°C Aligned Intensity Adjusted Profit (tCO2e/$M)	Alignment Gap Well Below 2°C (tCO2e)	Alignment Gap 2°C (tCO2e)	Alignment Gap 3°C (tCO2e)	Alignment Gap 4°C (tCO2e)	Alignment Gap 5°C (tCO2e)	Net Temperature (Overall)	Net Temperature (GEVA)	Net Temperature (SDA)
Portfolio	202.23	8,648,348	3,200,256	-314,667	-936,719	-1,533,496	2-3°C	2-3°C	3-4°C

Top 10 by Weight	% Weight	Alignment Gap Well Below 2°C (tCO2e)	Alignment Gap 2°C (tCO2e)	Alignment Gap 3°C (tCO2e)	Alignment Gap 4°C (tCO2e)	Alignment Gap 5°C (tCO2e)	Type	Methodology	Source of Forward Looking Data
Name 1	7.60%	333,427	-305,501	-685,723	-800,073	-868,178	<1.5°C	GEVA Modelled	Sub-Industry trend
Name 2	6.45%	12,407,051	6,556,383	2,047,342	2,678,026	2,061,009	1.5-2°C	GEVA	Sub-Industry trend
Name 3	5.55%	9,986,071	4,665,794	1,403,144	416,382	-189,206	1.5-2°C	GEVA	Sub-Industry trend
Name 4	0.43%	1,808,124	1,131,582	726,058	603,876	530,777	>5°C	GEVA	Sub-Industry trend
Name 5	0.40%	103,275	-227,286	-426,857	-487,076	-523,394	<1.5°C	SDA	Sub-Industry trend
Name 6	0.39%	2,615,764	1,321,700	539,235	303,088	160,206	<1.5°C	SDA	Company target
Name 7	0.39%	1,330,798	1,083,565	934,059	888,929	861,675	>5°C	GEVA	Company target
Name 8	0.33%	144,084	-310,278	-582,172	-664,045	-713,057	2-3°C	GEVA	Company target
Name 9	0.32%	-104,887	-490,981	-727,940	-799,715	-843,559	<1.5°C	GEVA	Sub-Industry trend
Name 10	0.31%	2,768,383	434,389	-1,001,746	-1,436,951	-1,703,748	<1.5°C	GEVA	Company target

Figure 4: Towards Net-Zero, Confluence Revolution ESG

Scenario analysis based on physical risks monitoring across different severities

SCENARIO ANALYSIS

The assessment of physical risks is key as they also (or mostly) result from climate change. Companies are scored 1-100 for each of the key hazard risk types (coldwave, heatwave, hurricane, floods, wildfire, water stress etc).
The assessment is made available across different climate change scenarios (low, medium, high) and future reference years (2030, 2050). In details:
- High climate change scenario (RCP 8.5) => continuation of business as usual with emissions at current rates. This scenario is expected to result in warming in excess of 4°C by 2100
- Moderate climate change scenario (RCP 4.5) => strong mitigation actions to reduce emissions to half of current levels by 2080. This scenario is more likely than not to result in warming in excess of 2°C by 2100
- Low climate change scenario (RCP 2.6) => aggressive mitigation actions to halve emissions by 2050. This scenario is likely to result in warming of less than 2°C by 2100.

	Low		
Sensitivity	2020	2030	2050
Composite	17.82	17.29	17.16
Coldwave	38.20	33.01	30.93
Flood	3.12	2.95	3.00
Heatwave	9.38	11.66	13.53
Hurricane	4.39	N/A	N/A
Sea Level Ris	3.09	3.14	3.71
Water Stress	58.56	59.80	61.02
Wildfire	22.96	22.21	20.77

	Medium		
Sensitivity	2020	2030	2050
Composite	17.55	17.51	16.79
Colwave	38.20	33.32	25.48
Flood	3.12	2.95	3.01
Heatwave	8.70	11.40	11.53
Hurricane	0.03	N/A	N/A
Sea Level Ris	3.08	3.14	4.55
Water Stress	58.56	59.80	60.99
Wildfire	22.96	23.45	24.01

	High		
Sensitivity	2020	2030	2050
Composite	17.92	17.26	17.53
Colwave	38.20	31.21	19.78
Flood	3.12	2.94	2.97
Heatwave	10.00	13.58	23.08
Hurricane	0.03	N/A	N/A
Sea Level Ris	3.08	3.14	5.69
Water Stress	58.56	58.22	57.51
Wildfire	22.96	23.38	24.35

Top 10 by Weight	% Weight	Sensitivity Composite Score 2020 (High Scenario)	Sensitivity Composite Score 2030 (High Scenario)	Trend	Coldwave Score 2030 (High Scenario)	Flood Score 2030 (High Scenario)	Heatwave Score 2030 (High Scenario)	Sea Level Rise Score 2030 (High Scenario)	Water Stress Score 2030 (High Scenario)	Wildfire Score 2030 (High Scenario)
Name 1	7.60%	4.87	3.98		32.10	1.21	14.77	1.00	71.40	54.28
Name 2	6.45%	16.76	16.50		31.99	4.16	13.00	3.73	52.92	10.58
Name 3	5.55%	26.98	26.16		30.13	3.25	13.78	3.59	54.09	13.62
Name 4	0.43%	10.00	10.00		30.00	4.00	11.00	5.00	57.00	12.00
Name 5	0.40%	14.00	14.00		32.00	5.00	12.00	6.00	58.00	12.00
Name 6	0.39%	18.00	17.00		28.00	2.00	12.00	3.00	59.00	11.00
Name 7	0.39%	52.00	49.00		31.00	7.00	12.00	11.00	31.00	17.00
Name 8	0.33%	40.00	37.00		32.00	1.00	10.00	1.00	44.00	2.00
Name 9	0.32%	5.00	5.00		26.00	2.00	19.00	1.00	87.00	18.00
Name 10	0.31%	13.00	13.00		33.00	6.00	13.00	3.00	42.00	11.00

Figure 5: Scenario Analysis, Confluence Revolution ESG

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Getting ready for SDR and TCFD

As UK firms prepare for the newly announced 2024 UK **SDR regulations** and the current TCFD regulations, forward planning and embedding an ongoing regulatory change program into investment operations is essential.

Working with a specialised ESG reporting technology and risk modelling vendor like Confluence, firms can simplify their ESG disclosure processes, leveraging integrated multi-vendor data sets and in-built complex modelling to meet their ever-evolving regulatory requirements.

Book a call and get ready for UK ESG disclosures

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