IMPLEMENTING THE TCFD RECOMMENDATIONS

Practical Example: Unilever
WHAT IS THE TCFD?

The Financial Stability Board’s Task Force on Climate-related Financial Disclosures (TCFD) was set up by the Bank of England Governor and Chair of the Financial Stability Board (FSB), Mark Carney, and is chaired by Michael Bloomberg. It was established to develop recommendations for more effective climate-related financial disclosures that:

• Could promote more informed investment, credit and insurance underwriting decisions
• Would enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector and the financial system’s exposures to climate-related risks

One of the recommendations of the TCFD is to perform scenario analysis to assess potential business implications of climate related risks and opportunities.

HOW A4S SUPPORTS THE TCFD

The Prince’s Accounting for Sustainability Project (A4S) supports the adoption of the TCFD recommendations. To do this, we work with key stakeholder groups to build awareness and provide access to the skills and knowledge required for implementation. Some of our activity has included:

• Providing a platform for CFOs, Pension Fund Chairs and Accounting Body CEOs to signal their commitment to support the recommendations and work with their peers in a united effort to improve disclosure across sectors and regions – see A4S Statements of Support for the TCFD recommendations.
• Running implementation workshops for finance teams around the world to provide practical steps that can be taken to embed the recommendations within organizations.
• Publishing a ‘TCFD Implementation: Top Tips for Finance Teams’ booklet, based on the experiences of early adopters of the TCFD recommendations shared during the A4S TCFD workshop series.
• Providing insight into how corporates have implemented the TCFD recommendations by publishing detailed case studies (including this one) on the steps taken, challenges faced and barriers overcome.
It’s fundamental for every good business to manage and communicate risks and opportunities. We are already obliged to disclose material risk – climate change is no different. It’s a risk that is already affecting companies today – both through the impacts of steadily rising global temperatures and through the policies that governments around the world adopt in response.

As part of the Task Force, we have put together a standardized framework for companies to disclose climate-related risks and opportunities, focusing on making them as practical as possible to adopt. Why? Because markets need information to operate efficiently. We have to be transparent to help investors make better decisions for the long term. And beyond the markets, we know that transparency is increasingly important to our consumers too. They want to know the values of the companies they are buying from, particularly millennials. The same goes for the young talented future leaders we all wish to recruit.

In our 2019 Annual Report, we disclosed details of our scenario analysis and the material impacts that might arise from 2°C and 4°C warming scenarios. Whilst we have been reporting on our actions to mitigate the effects of climate change for some time, this was the first time we reported on the exposure of our business to physical and transition climate risks, and our plans to ensure we remain resilient in the future. We hope that by sharing our experience in conducting and disclosing the outcomes of the scenario analysis, other companies will follow suit. I’d urge all companies to adopt the recommendations.

Graeme Pitkethly, Chief Financial Officer, Unilever

“...this was the first time we reported on the exposure of our business to physical and transition climate risks, and our plans to ensure we remain resilient in the future.”
WHAT?

In 2017 at Unilever, we performed scenario analysis as part of our commitment to the TCFD recommendations. We used two simple, distinct and discrete scenarios which were:

i) 2°C, transition impacts only
ii) 4°C, physical impacts only

The results of the scenario analysis were used in our disclosure in our Annual Report.

WHY?

We needed to understand the impact of climate change on our business. At Unilever, we have a huge and complex supply chain where we knew the majority of our risks and opportunities would lie. We wanted to ensure that this piece of work would feedback into the business to influence decisions, rather than just being a disclosure exercise. We found great value in the internal conversations that this piece of work prompted. As well as this, our CFO was vocal about our need to disclose, both with the Board and the finance team.

HOW?

We took inspiration from other companies when they shared their work on scenario analysis. This led us to understand their methodologies, then adapt it for our purposes.

To help our scenario analysis succeed, we focussed on keeping it as simple as possible, while still being useful. To this end, we started by considering just two scenarios and using simplifying assumptions.

We started by forming a small project team, led by finance, that included enthusiastic colleagues from other functions.

We also used the support of external third parties where we felt they had expertise and knowledge which would improve the quality of the analysis. We have summarized the key steps we took on the following pages.

WHAT DOES THE TCFD SAY ABOUT TRANSITION AND PHYSICAL RISKS?

Transition impacts

Transitioning to a lower-carbon economy may entail extensive policy, legal, technology, and market changes to address mitigation and adaptation requirements related to climate change. Depending on the nature, speed, and focus of these changes, transition risks may pose varying levels of financial and reputational risk to organizations.

Physical impacts

Physical risks resulting from climate change can be event driven (acute) or longer-term shifts (chronic) in climate patterns. Physical risks may have financial implications for organizations, such as direct damage to assets and indirect impacts from supply chain disruption. Organizations’ financial performance may also be affected by changes in water availability, sourcing, and quality; food security; and extreme temperature changes affecting organizations’ premises, operations, supply chain, transport needs, and employee safety.
PHASE 1 – GENERAL SCENARIOS

We made the following simplifying assumptions for each scenario:

**Scenario 1**
- Global warming limited to 2°C by 2100
- Transition impacts only (assume no significant physical impacts)
- Assume society acts rapidly to limit greenhouse gas emissions e.g. through carbon prices and halting net deforestation

**Scenario 2**
- Global warming limited to 4°C by 2100
- Physical impacts only (assume no significant transition impacts)
- Assume climate policy is less ambitious and emissions remain high so the physical impacts are more apparent e.g. water stress, droughts, floods

Despite the recent Intergovernmental Panel on Climate Change report focusing on 1.5°C, we decided not to do a 1.5°C scenario because we felt that the two chosen scenarios would provide the best basis to assess the impact of climate change on our business.
BUSINESS IMPACTS

We focused on understanding the impact on our P&L, in particular, revenue, manufacturing costs and sourcing costs. To select our data we combined:

- Temperature outcome in 2100 (i.e. 2°C vs 4°C)
- Unilever’s historic internal financial data from 2015

We used these to understand the potential impact on our business in 2030.

DATA

Both internal and external data was needed for our scenario analysis. External data was used to understand the climate related risks and opportunities. This was then mapped against internal business data to show the area of business impact. We used surrogate or proxy data (e.g. carbon footprint data, commodity prices) and other assumptions to fill data gaps.

External data – We used data from the IEA’s World Energy Outlook and climate impacts associated with the IPCC’s RCP 8.5

Internal data – We used 2015 forecast sales, greenhouse gas (GHG) emissions and tonnes of commodities used.

ASSUMPTIONS

In the scenarios, we made the following assumptions:

- No Unilever response: We have not factored in any Unilever mitigation, adaptation or innovation
- All impacts are gross
- Unilever absorbs all cost increases
EXAMPLE IMPACT FLOWS

To illustrate the thought process that we went through to understand the P&L impact, we have provided some examples of the impact flow. By combining our historic financial data with external data for each characteristic, we were able to calculate approximate financial values for each impact.

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Characteristic</th>
<th>Impact on Unilever</th>
<th>P&amp;L Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>2°C Scenario</td>
<td>Carbon price</td>
<td>Manufacturing Increases electricity, fuel and distribution costs</td>
<td>Cost of sales</td>
</tr>
<tr>
<td>4°C Scenario</td>
<td>Water scarcity</td>
<td>Raw material prices Increases electricity, fuel and fertilizer prices</td>
<td>Cost of sales</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Manufacturing Increases costs and causes damage/disruption</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Raw material prices Limits supply, increasing prices</td>
<td></td>
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</tbody>
</table>
Our Disclosure

At the time of writing we have disclosed the results of our scenario analysis in two of our Annual Reports and Accounts.

For these disclosures, we wanted to explain our work in simple language to help it to be understood by all audiences. The disclosures have been well received by the market in general. The TCFD suggested that they would like to see more figures disclosed, which is something we are working towards.

Description of Risk

**Risk**

A skilled workforce and agile ways of working are essential for the continued success of our business.

Our ability to attract, develop and retain the right number of appropriately qualified people is critical if we are to compete and grow effectively.

This is especially true in our key emerging markets where there can be a high level of competition for a limited talent pool. The loss of management or other key personnel or the inability to identify, attract and retain qualified personnel could make it difficult to manage the business and could adversely affect operations and financial results.

**What We Are Doing to Manage the Risk**

Resource committees have been established and implemented throughout our business. These committees have responsibility for identifying future skills and capability needs, developing career paths and identifying the key talent and leaders of the future. We have an integrated management development process which includes regular performance reviews underpinned by a common set of leadership behaviours, skills and competencies.

We have targeted programmes to attract and retain top talent and we actively monitor our performance in retaining talent within Unilever.

We regularly review our ways of working to drive speed and simplicity through our business in order to remain agile and responsive to market place trends.

Supply Chain

Our business depends on purchasing materials, efficient manufacturing and the timely distribution of products to our customers.

Our supply chain network is exposed to potentially adverse events such as physical disruptions, environmental and industrial accidents, trade restrictions or disruptions at a key supplier, which could impact our ability to deliver orders to our customers.

The cost of our products can be significantly affected by the cost of the underlying commodities and materials from which they are made. Fluctuations in these costs cannot always be passed on to the consumer through pricing.

Changes in trade relationships between Europe and the UK as a result of Brexit could give rise to both a supply and cost issue.

**What We Are Doing to Manage the Risk**

We have contingency plans designed to enable us to secure alternative key material supplies at short notice, to transfer or share production between manufacturing sites and to use substitute materials in our product formulations and recipes.

We have policies and procedures designed to ensure the health and safety of our employees and the products in our facilities, and to deal with major incidents including business continuity and disaster recovery.

Commodity price risk is actively managed through forward buying of traded commodities and other hedging mechanisms. Trends are monitored and modelled regularly and integrated into our forecasting process.

Contingency plans are being developed to minimise any disruption.

Safe and High Quality Products

The quality and safety of our products are of paramount importance for our brands and our reputation.

The risk that raw materials are accidentally or maliciously contaminated throughout the supply chain or that other product defects occur due to human error, equipment failure or other factors cannot be excluded.

**What We Are Doing to Manage the Risk**

Our product quality processes and controls are comprehensive, from product design to customer shelf. They are verified annually and regularly monitored through performance indicators that drive improvement activities. Our key suppliers are externally certified and the quality of material received is regularly monitored to ensure that it meets the rigorous quality standards that our products require.

In the event of an incident relating to the safety of our consumers or the quality of our products, incident management teams are activated in the affected markets under the direction of our product quality and communications experts, to ensure timely and effective market place action.

Systems and Information

Unilever’s operations are increasingly dependent on IT systems and the management of information.

The cyber-attack threat of unauthorised access and misuse of sensitive information or disruption to operations continues to increase. Such an attack could inhibit our business operations in a number of ways, including disruption to sales, production and cash flows, ultimately impacting our results.

In addition, increasing digital interactions with customers, suppliers and consumers place ever greater emphasis on the need for secure and reliable IT systems and infrastructure and careful management of the information that is in our possession to ensure data privacy.

**What We Are Doing to Manage the Risk**

To reduce the impact of external cyber-attacks impacting our business we have firewalls and threat monitoring systems in place, complete with immediate response capabilities to mitigate identified threats. We also maintain a global system for the control and reporting of access to our critical IT systems. This is supported by an annual programme of testing of access controls.

We have policies covering the protection of both business and personal information, as well as the use of IT systems and applications by our employees. Our employees are trained to understand these requirements. We also have a set of IT security standards and closely monitor their operation to protect our systems and information.

Hardware that runs and manages core operating data is fully backed up with separate contingency systems to provide real-time backup operations should they ever be required.

We have standardised ways of hosting information on our public websites and have systems in place to monitor compliance with appropriate privacy laws and regulations, and with our own policies.
USING THE RESULTS OF OUR SCENARIO ANALYSIS

Presenting the financial impact of long-term risks, such as climate change, draws attention to it as a priority. This has allowed senior management to assess materiality, compare to other issues and determine how much resource to use in addressing the issue, i.e. it contributes to the overall business case and confirmed we are doing the right thing. Our analysis showed that, without action, both scenarios present financial risks to Unilever by 2030, predominantly due to increased costs in our supply chain where costs of raw materials and packaging would rise.

We also found that the development of climate models and scientific research around climate change is still evolving and progressing, therefore we need to continue to update our models as the science progresses to make them as decision-useful as possible.

PHASE TWO – DEEP DIVE ON SOY

The results of our scenario analysis confirmed the importance of doing further work to ensure that we have action plans in place to help mitigate the risks of climate change and to prepare the business for the future environment in which we will operate.

We knew that the biggest impacts would be in our supply chain so we decided to focus on our largest ingredients. We piloted an analysis for soy first, as it is one of our most important ingredients, it is a high-profile crop in the countries where it is grown and has good availability of historical price data and suitable climate models.

HOW

We performed thorough data availability and robustness scans before starting the work, to ensure we were minimizing uncertainty in the data, whilst simplifying the process as much as possible. Once we had collated the external and internal data sets we wanted to use, we had visibility over our data gaps and we agreed assumptions that would help to cover these.

The pilot model we developed used the direct risks from climate change to the price of soybean oil, such as change in yield and change in supply. Three steps were performed:

1. We estimated future yields by analysing external agricultural and climate models in key growing regions.
2. We estimated the impact on future prices of soy as a result of climate-related yield changes.
3. The future yields and price impacts were then used to calculate the estimated financial impact from climate change for our business, based on our forecast purchasing volumes.

The model was built in such a way that it could be used to analyse other ingredients.

NEXT STEPS

At the time of writing, we have completed our business level analysis and our deep dive on soy and incorporated it into our disclosures in our Annual Report and Accounts 2018. The next step is for us to model the impacts of climate change against two of our other key ingredients, tea and palm oil.

We will continue to refine the approach, with a focus on delivering insight for the decision makers throughout our organization. As we refine the work, we expect to find it easier to complete the analyses and have more fluency with internal resources.

We will continue to work on how best to facilitate discussions on TCFD and scenario analysis within the business to get the full value from this approach.
Executives will want to have oversight over anything that will end up in the annual report. It was crucial to have the support of our CEO and CFO to help obtain resources and to get space in the annual report. If your leadership is not bought in, your first step should be to engage with them on this topic.

Get senior buy in

It was particularly useful to understand what the aim was for us. We decided what the outcome would look like, which data sets to use, which data we had available, which assumptions to use and which simplifications to use all before we started using figures.

Do the ‘thinking’ up front

Scenario analysis isn’t designed to provide a forecast, so don’t present it as one. Executives will be used to exact data to make their decisions which scenario analysis cannot provide. What it does provide is a range of possibilities which help decision makers to think differently. This caveat should be communicated upfront to help senior management understand the information.

Understand how to communicate scenarios with executives

Scenario analysis required us to utilize different skillsets from across the business. Colleagues from Research and Development, Procurement, Sustainable Sourcing, Commodities and Finance teams were all involved, with the support of third party consultants. We didn’t have a huge team to dedicate resource to this, but we use those in the business who were knowledgeable and enthusiastic.

Mobilize a cross functional team

Forward looking data will always have limitations. This is why we did two scenarios with very different features. We were able to understand the possibilities from both scenarios and assume that the actual impact on our business is likely to be somewhere in the middle.

Understand the limitations of models

Because of the previous work we had done on greenhouse gases in our value chain, we were able to use this data here, however if we didn’t, we would have used the data available to us. The data will never be perfect, but scenarios can still provide insight if based on data available to every organization, such as sales data, purchases data or operational expenses data.

Start with what you’ve got

Scenarios become more complicated the more variables there are. This is why we simplified our project to have two distinct scenarios at first. Once the first analysis has been completed, scenarios can be made more complex. In our case we used the first analysis to understand risks at a business wide level, then created specific scenarios at the commodity/ingredient level.

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