



## Making sense of corporate climate disclosures

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*Corporate climate disclosures can be a potent signal to investors. Reliance on fossil fuels can indicate exposure to transition risks, while concentration of production sites in flood-prone areas may reveal high exposure to physical risks. But for forward-looking investors to turn signals into prices, climate-related information needs to be available and understandable.*

*Some firms have opted to join global initiatives to signal adherence to the goals of the low-carbon transition. But so far, it has been unclear whether such commitments are meaningful in mitigating transition and physical risks.*

**Julia Bingler et al.** (2022), in [“Cheap Talk in Corporate Climate Commitments: The effectiveness of climate initiatives,”](#) employ ClimateBert, a model based on natural language processing (NLP), to extract climate commitments from 14,584 annual reports. Based on the ratio of precise to imprecise commitments, they calculate a “cheap talk index” for the firms of the MSCI world index. The authors find that firms committed to voluntary disclosure initiatives such as the TCFD tend to disclose more cheap talk. This confirms their [earlier findings](#) that firms’ climate disclosures did not considerably increase after committing to the TCFD recommendations, and that these firms tend to “cherry-pick” the least materially relevant information in their disclosures. Engagement by institutional investors through initiatives like the CA100+ considerably increases the quality and decision-relevance of climate commitments. The authors suggest that seeking outside help to define science-based targets should be complemented with timelines and precise measures in order to increase credibility.

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## Understandable disclosures are precise, mandatory and standardized

*Voluntary climate disclosure initiatives are prone to "cheap talk," imprecise, and difficult to compare.*

**Patrick Bolton et al.** (2021), in their policy note "[Mandatory corporate carbon disclosures and the path to net zero](#)," promote mandatory corporate carbon disclosures. They argue that this is a realistic goal, given the expertise of data providers, a broad consensus on effectiveness, and the regulatory infrastructure in many parts of the world. Stakeholders need to compare direct GHG emissions across companies, which they argue has led to emission reductions in markets where disclosures are already mandatory. To avoid emissions-intensive activities to "migrate," such an initiative would have to apply to all corporations, globally.

**Paul Griffin and Amy Myers Jaffe** (2022), comment on the "[Challenges for a climate risk disclosure mandate](#)," in *Nature Energy*. Heterogeneous corporate governance systems – a blockholder system as in Eastern Asia and parts of Europe and a dispersed shareholder model as in the US – have different information needs. TCFD-style mandatory disclosures may work in a system of dispersed shareholders, but in a blockholder system, they can actually worsen information asymmetry if reported information is packaged into ESG products, which reduce transparency.

*While standardized carbon disclosures are useful at the firm-level, they may not solve the investor's challenge to sort the risky firms from the resilient ones. Past emissions are only one step in the construction of forward-looking metrics which must rely on transparent assumptions and models to ensure understandability and comparability.*

**Julia Bingler, Chiara Colesanti Senni, and Pierre Monnin** (2022), in "[Understand what you measure: Where climate transition risk metrics converge and why they diverge](#)," analyze the transition risk assessments of nine data providers for the MSCI world index companies. They find that estimated risk values tend to converge for most exposed companies. They conclude that this should enable investors and financial supervision to account for these risks, for example in credit risk analysis or collateral framework provisions. For less exposed firms, they find that heterogeneity is driven by the variance in underlying methodologies as well as scenarios. The authors conclude that climate risk disclosures must include information on both methods and assumptions in addition to the final metrics. To put research into practice, these findings were transformed into a precise science-based disclosure guidance and templates for forward-looking metrics by the [WWF's Greening Financial Regulation Initiative](#).

"[Do investors care about carbon risk?](#)" ask **Bolton and Kacperczyk** (2021). They find that exposure to carbon risk does increase investors' demand for higher returns, independently of firm-level differences in profitability and other observable risk factors. The result is partly driven by institutional investors who treat companies with high carbon emissions as "sin stocks."



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