DISCLOSURES IN A TIME OF ENERGY TRANSITION: SUPPORTING STEG'S CORPORATE CLIMATE GOVERNANCE REFORM

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The article[1] provides an overview of the climate-related financial disclosures in the energy sector as a key driver for market-wide climate action. The authors argue that there is a key role for the EBRD and other multilateral development banks to play in supporting energy transition by helping their clients implement the Task Force on Climate-related Financial Disclosures. The article highlights a pilot project in Tunisia, an emerging economy, where the EBRD steps in both as an investor providing financial stability to a client in times of Covid-19, and as a policy adviser to help develop the client’s corporate climate governance and climate action.

A YEAR OF MILESTONES FOR THE EBRD

The urgency of the climate crisis and the fundamental risk it poses to humanity has risen to the forefront of business, economic and political discussions during the Covid-19 pandemic.

In these uneasy times, the EBRD has scaled up support to the economies where it operates through investment, policy advice and technical assistance. To name a few milestones in 2020, the EBRD approved its Covid-19 Solidarity Package,

1 The authors would like to thank Zeynep Boba, Consultant, EBRD, for her research and assistance in the drafting of this article.

issued the new Green Economy Transition 2021-25 (GET) approach, and developed its first Task Force on Climate-related Financial Disclosures (TCFD) status report.[2]

As envisaged in the EBRD's founding document, the Agreement Establishing the Bank, the EBRD is committed to "promoting environmentally sound and sustainable development in the full range of its investment and technical cooperation activities". As part of its new GET approach the EBRD has committed to: (i) achieving a green finance ratio of over 50 per cent of the total annual investments by 2025; (ii) aligning its financial flows with the Paris Agreement on climate change; and (iii) enhancing its policy work to achieve a systemic impact in its regions.[3]

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CLIMATE-RELATED FINANCIAL DISCLOSURES

In today's environment, organisations can no longer ignore the impact that climate change has on their assets, portfolio and supply chains. There is a global trend for companies to respond to the risks and opportunities related to these impacts, as well as an expectation of transparency through financial and non-financial reporting.

Company executives are increasingly aware of the need to develop governance and risk management tools to integrate assessment and management of climate change-related impacts into financial and business decision-making. This is needed in order to optimise business performance, economic output and financial stability in the face of the physical impacts of climate change and the necessary decarbonisation of the global and local economy.

This shift is being reinforced by recommendations and emerging regulatory frameworks from the industry-driven TCFD, the European Commission's Sustainable Finance Action Plan and a number of national regulatory and supervisory bodies. The importance of informing market participants of how organisations manage their climate risks is recognised in the GET.

Set up by the Financial Stability Board in 2016, the TCFD examines climate change in a financial stability context and provides guidance for organisations on how to reduce their impact on the environment and to address the adverse effects of climate change on their business.

The TCFD recommendations ask for a better understanding of climate risk and climate-related financial disclosures, and are structured around four major areas – governance, strategy, risk management, and metrics and targets – adoptable across sectors and jurisdictions.

2 The EBRD became a Task Force on Climate-related Financial Disclosures (TCFD) supporter in March 2018, requiring the EBRD to begin disclosing its exposure to climate-related risks and opportunities like any other company. In 2020 the EBRD took its climate-related disclosure a step further by publishing a standalone report on the steps it is taking to follow the recommendations of the TCFD. The published report is an important milestone for the EBRD process of aligning its metrics and disclosure relating to climate risks and opportunities to those of other organisations, while formulating plans to become a majority green bank by 2025.

3 The EBRD would screen all investments for alignment with the Paris Agreement and national climate-related action plans, taking into consideration the priorities set in country and sector strategies. It would also increase its capacity to support economies, regions and sectors to develop low carbon and climate resilience strategies and scale up its efforts to mobilise climate finance.

TCFD IMPLEMENTATION BY THE ENERGY INDUSTRY

The TCFD 2020 status report includes a review of the disclosures of 274 energy companies. The energy industry remains one of the best-performing industries in terms of quality and coverage of TCFD recommendations and had the highest percentage of disclosures for 2019 (which reaches an average of 40 per cent).[4] The assessed companies include major oil and gas organisations and energy utilities, which have been under increasing scrutiny by investors and society on their exposure to climate risk.

The top-performing companies with regard to climate-related financial disclosures are predominantly from Europe (that is, France, Italy and the United Kingdom) and Australia. This is driven by a number of factors, including statements by financial regulators signalling their expectations regarding climate-risk disclosures, the increased focus among banks and investors to direct capital allocation to green projects, and shareholder and consumer pressure.

INTEGRATING CLIMATE-RELATED GOVERNANCE AND DISCLOSURE INTO INVESTMENT PROJECTS

There is a shortage of companies from emerging economies committing to disclose their policies on identifying and managing climate-related financial risks and opportunities. Developing countries and emerging economies may be more vulnerable to climate change due to low-income levels, poor infrastructure, weak corporate governance culture, dependency on fossil fuels, deficient legal and institutional frameworks resulting in a scarcity of climate-related data, and low market action on building climate resilience.[5] Adding unquantifiable climate-related risks to the existing, at times, commercial, legal and geopolitical risks, turns away potential investment, especially as investors are looking for green finance market opportunities.

In accordance with its focus on sustainability, climate action and energy sector policy, the EBRD has pledged to help its clients develop effective corporate climate governance and climate disclosure mechanisms and policies.

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One of the EBRD's first investment projects integrating corporate climate governance is with Société Tunisienne de l'Electricité et du Gaz (STEG). STEG is Tunisia's wholly state-owned, vertically integrated national electricity and gas utility, and is under the administration of the Ministry of Energy, Mines and Energy Transition (the Ministry).

STEG was founded in 1962, when the Tunisian government decided to nationalise the generation, transmission, distribution, import and export of electricity and gas, entrusting these activities to STEG. STEG has the monopoly on distribution and transmission of electricity and gas, and acts as the single buyer for all the electricity generated. It controls electricity generation thanks to its ownership of 90.2 per cent (4,582 MW as of 2018) of domestically installed capacity.

Overview of Tunisia's energy sector and key challenges

For more than two decades, Tunisia has focused on the rational use of energy and a gradual development of renewable energies. Due to its ambitious energy demand management programmes, the country has reduced the growth

4 See https://www.fsb.org/wp-content/uploads/P291020-1.pdf (accessed 22 December 2020).

5 V. Haralampieva (2019), *Law in transition*, Enhancing companies' governance framework for ramping-up climate action.

rate of energy consumption and substantially improved energy intensity.[6]

Despite these efforts, the Tunisian energy mix remains heavily dependent on fossil fuels with demand for electricity still growing. The international context, characterised by a sustainable rise in energy prices, clean energy policies and investors' expectations for energy decarbonisations will significantly influence the energy situation in Tunisia.

The Tunisian government has targeted two priority actions for its energy strategy for 2030, namely strengthening energy efficiency (through, among other things, improving energy independence by reducing consumption of fossil fuels and reducing greenhouse gas [GHG] emissions) and the use of renewable energies. Tunisia's mitigation efforts under the country's Nationally Determined Contributions (NDCs) are mainly focused on the energy sector, as it is the biggest contributor to direct gross GHG emissions (it accounts for 75 per cent of the proposed emission reductions).[7]

STEG is the central and critical player in the Tunisian electricity and gas sector. Given its responsibilities as transmission system operator, single buyer of electricity, and electricity distributor and producer, its long-term sustainability is critical for Tunisian social and economic stability and green energy transition. STEG is heavily dependent on gas imports. The absence of substantial tariff reform and, more recently, the Covid-19 crisis have exacerbated liquidity issues.

STEG's stability and efficiency is essential both for the success of Tunisia's renewable programme (since STEG is the long-term purchaser of all renewable power) and for the stability of energy supply in Tunisia. In this context, the EBRD has been approached to support STEG's ambitious long-term reform objectives in the electricity sector while providing STEG with an immediate response to the Covid-19 crisis.

STEG INVESTMENT AND POLICY ROADMAP INTEGRATING CORPORATE CLIMATE GOVERNANCE AND DISCLOSURE MEASURES

On 30 December 2020 the EBRD signed a loan agreement with STEG, which combines long-term reform objectives with an immediate response to the Covid-19 crisis. The proceeds of the EBRD's loan will be used to: (i) stabilise STEG in light of the Covid-19 crisis; and (ii) refinance its short- and medium-term debt to provide terms more consistent with STEG's operations, with the purpose of contributing to the financial stability of STEG.

To respond to the country's energy priorities and in accordance with its transition mandate, the EBRD, in cooperation with the Ministry and STEG, has put together a comprehensive roadmap to reform and restructure STEG, which is integrated into the investment project. Most of the envisaged ambitious measures will be developed with the EBRD's technical assistance, which would aim to achieve the long-term sustainability of STEG and the Tunisian energy sector.

Disbursements of the EBRD's loan are linked to STEG's implementation of the reform and energy sustainability roadmap. The roadmap aims to: (i) improve the company's corporate and climate governance and disclosures; (ii) enhance financial management of the company; and (iii) promote a series of inclusive initiatives both at the company and industry levels to support equal opportunities and career development for women and young professionals in the energy sector.

As part of this roadmap, the EBRD developed a Corporate Climate Governance Action Plan (CCGAP), aimed at enhancing the company's governance and management of climate-related risks and opportunities and drawn on TCFD recommendations.[8]

6 Thanks to these programmes, to produce the same level of wealth (GDP-wise), Tunisia today consumes 20 per cent less energy than in 2000.

7 The country is committed to reducing carbon intensity by 41 per cent (13 per cent unconditionally and another 28 per cent conditionally) between 2010 and 2030. In accordance with the country's national strategies and energy transition agenda, the country plans to increase to 30 per cent the penetration rate for renewable energy in electricity production. See https://www4.unfccc.int/sites/ndcstaging/PublishedDocuments/Tunisia%20First/INDC-Tunisia-English%20Version.pdf (last accessed 22 December 2020).

8 The project also promotes the EBRD's inclusion agenda – for example, by helping young people to improve their skills and supporting gender equality in terms of access to economic opportunities.

The main objectives of the CCGAP are to ensure that:

- the company's board is tasked with environmental and climate matters, including the approval of the corporate strategy (which features climate-related key performance indicators [KPIs])
- the management has the adequate tools to assess climate risks and prevent them from materialising as well as to identify and assess climate-related opportunities
- the policies adopted by the company, in particular those related to climate matters, are complied with by the operational divisions and the management
- STEG makes adequate disclosures to the public, in particular on matters related to identification and management of climate-related risks and opportunities in line with international voluntary climate-related disclosure standards (for example, TCFD, CDP, or others).

Taking into account the four pillars of the TCFD, some critical actions under the CCGAP can be identified as follows.

1. **Governance.** Under the CCGAP, STEG is required to ensure clear reporting and accountability lines in the company and to map all key functions, including environmental and climate-related matters. Another action refers to strengthening the responsibilities of STEG's board so that it is clearly tasked with approving the company's strategy and budget and determining its risk appetite, including in relation to climate-related risks and opportunities. Considering the challenges that state-owned enterprises (SOEs) face in making any governance changes, STEG committed, on a best efforts basis, to adopt a new charter and, once enabled by the relevant new legislation, to approve the new board's bylaws. The EBRD is working closely with the relevant policymakers to ensure timely adoption of this legislation.
2. **Strategy.** Once the board is equipped with the responsibilities regarding strategy approval, STEG will adopt a corporate strategy aligned to a defined budget and risk appetite with clear and defined KPIs that shall include climate-related issues.

3. **Risk management.** The company's due diligence showed that it needed to strengthen its risk management function by adopting a risk register, developing an internal risk management framework with a methodology and tools to establish climate-related risks and opportunities. A stronger risk function is required for better identification, assessment and management of climate-related risks and opportunities.

4. **Metrics and targets.** The company will have to develop specific metrics and targets for mitigating its impact on climate change (for example, developing renewable energy sources and adopting energy efficiency measures) and preventing physical climate risks from negatively affecting the company's assets and investments. In order for STEG to be able to disclose the metrics and targets used to assess and manage relevant climate-related risks, it is essential that the company improve its corporate governance disclosure in its annual report and website, including introducing climate-related reporting in line with international frameworks and standards.

While it contains improvements to "traditional" corporate governance elements (that is, the role and composition of the board and audit committee, a stronger internal control function and so on), the CCGAP focuses on specific climate actions that reflect international standards and that are innovative for the Tunisian market.

When implemented, the climate actions will lead to strategic and organisational changes in the company. Such changes will ensure that climate-related risks and opportunities are effectively identified, assessed and managed so as to inform STEG's decision-making process. Further, it will lead to the development of a corporate strategy with a progressive and clear climate-related strategic direction with multiple time horizons, which will have an impact on future investment plans and a natural shift towards renewables.

STEG has also committed to publishing climate-related data, including the company's enhanced climate governance, climate metrics and targets,

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which, once publicly available, are expected to have a positive impact on the country's energy sector.

STEG's implementation of these ambitious climate actions is expected to act as a model for other SOEs and the energy market in Tunisia, given that STEG is one of the most important SOEs in Tunisia (in terms of the number of employees). As noted above, climate-related governance and disclosure are still uncommon for energy companies in emerging markets; in fact, there is not yet a Tunisian company listed as a TCFD supporter (as of January 2021). In addition, this is one of the first CCGAPs developed by the EBRD with a public utility company and it is expected that it will have a wide impact on the Tunisian and regional energy markets.

Due to their market position, electric utilities in particular have a central role to play in leading a transition to the low-carbon economy, driven by electrification and decarbonisation. The transition and development of generation and non-generation fossil-free activities while ensuring security of supply present great challenges.[9] At the same time, the companies that assess and manage their climate risks will be among the first to identify and implement opportunities revealed by the new technology, green finance and consumer preference.

9 See https://www.wbcsd.org/Programs/Redefining-Value/External-Disclosure/TCFD/Resources/Disclosure-in-a-time-of-transition-Climate-related-financial-disclosure-and-the-opportunity-for-the-electric-utilities-sector (last accessed 22 December 2020).

CONCLUSION

There are significant gaps between climate disclosure standards and evolving regulation in Europe and other leading jurisdictions on the one hand, and the levels of disclosure in emerging markets on the other. Given these challenges, and in line with their climate commitments, the EBRD and other multilateral development banks have a vital role to play in helping their clients address climate-related risks and identify business opportunities.

Energy utilities are key players in advancing the green energy transition and building climate resilience. The ones that are able to realise and implement climate-related opportunities offered by new technologies, infrastructure and customer solutions would create a substantial value for their businesses and for the wider society. Through the investment in STEG and its technical assistance programme, the EBRD will help ensure financial stability in times of crisis and contribute to the long-term sustainability of the company. As the company develops its corporate climate governance and climate strategy, it will identify the most effective pathways for reducing emissions and introducing energy efficiency measures.

As it implements the reform roadmap, STEG will transition towards a profitable, more efficiently run and modern SOE, and be in a better position to mitigate risks and promote the development of green energy in the country over the medium and long term.