ClientEarth

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UK listing rules and climate change

Position Paper

Background

ClientEarth is a non-profit environmental law organisation headquartered in London. ClientEarth's Climate Finance initiative analyses the legal implications of climate change-related financial risks for a wide spectrum of market participants, including companies and their directors, investors, professional advisers and regulators, and has long advocated for better integration of climate-related disclosure, risk-management and transition planning into the UK financial regulatory framework.

This position paper concerns the manner in which the UK listing regime would operate if an oil and gas company, a thermal coal company or any other carbon-intensive or climate-exposed company (referred to throughout this note as "**climate-exposed companies**"), sought a premium listing and admission to trading on the main market of the London Stock Exchange (**LSE**). It is essential that the UK listing regime is brought into line with UK climate commitments, and the recognition (evident in emerging UK disclosure regulations) that climate-related financial risk must be adequately disclosed and managed by companies on an ongoing basis once they are listed.

After explaining this issue in more detail, this position paper sets out a series of recommendations as to how the Financial Conduct Authority (**FCA**), as UK Listing Authority, must strengthen its approach to climate change-related risk at the point a climate-exposed company applies for listing, consistently with its regulatory objectives, UK climate commitments, and the protection of investors. On 11 April 2022, ClientEarth met with the FCA to discuss the issues set out in this paper, and we are continuing to engage with the FCA on this topic.

Summary

Introduction

Climate change is a unique systemic risk which threatens: (a) the financial position of companies and investors; and (b) the integrity of the UK (and global) financial markets. The LSE is already significantly exposed to "stranded asset" risk associated with fossil fuel assets held by listed companies.

The FCA has introduced climate-related disclosure requirements for listed companies, but missed the opportunity to impose consistent climate-related conditions and controls at the point a company applies for listing – the point at which the regulator has most leverage over applicant companies. As a result, the current system in practice permits companies to list on the main market of the LSE even when their business models are incompatible with the climate goals of the Paris agreement and the transition to a low-carbon economy, exposing investors to additional risk.

Problem statement

Allowing climate exposed companies to list on the main market of the LSE without appropriate conditions and controls is inconsistent with:

- climate science and the goals of the Paris Agreement;
- UK climate commitments,
- investors' interests; and
- the FCA's objectives.

The approval of such listings is also vulnerable to legal challenge.

See **Section 1**.

Available powers

The FCA has a range of powers available to it to manage the risks presented by climate-exposed listings, including:

- investor protection to refuse a listing application or impose conditions;
- heightened scrutiny of "high risk" transactions during eligibility review;
- control over prospectus approval; and
- oversight of sponsors.

See **Section 2**.

Our recommendations

The FCA should use its powers to mitigate investor and market climate risk by:

- Making demonstrable Paris-alignment a condition of listing for climate-exposed companies;
- Treating climate-exposed listings as "high risk" transactions subject to heightened scrutiny during eligibility review; and
- Issuing clear and authoritative guidance to the market explaining its approach to climate-exposed listings.

See **Section 3**.

Other considerations

In light of the evolving policy context in the UK, commitments to net-zero finance made by the UK Government at COP26, and the related commitment to make transition plans mandatory, there is an opportunity for the FCA to show global leadership among regulators in relation to the UK listing regime and climate change.

This could be done in a way that is consistent with the FCA's focus on ensuring the UK listing regime remains attractive and competitive to issuers, and the ongoing requirements of the listing rules in relation to climate change (i.e. TCFD and, in future, SDR and transition plans).

As explained in this position paper, we believe the FCA has existing powers which enable it to intervene effectively in this area. We recognise, however, that in order to send a clear signal to the market regarding its change of approach, the FCA may wish to establish a new rule covering listings and climate change.

Regardless of the regulatory route to reform, we urge the FCA to take action as soon as possible given the urgency of effective action to align financial flows with the UK's climate commitments, with wholesale transformations across the economy required before 2030. If the introduction of a new rule would require lengthy consultation, or be otherwise delayed pending broader reform of the prospectus regime and / or the outcome of the FCA's efforts to modernise the listing rules, then the FCA should prioritise the use of existing powers at its disposal to accelerate an effective response to the issues presented in this position paper.

1. Problem statement

Despite climate-related commitments from the FCA and the LSE, a climate-exposed company can currently achieve a premium listing and admission to trading on the main market of the LSE, with relatively little scrutiny of its climate risks and impacts, attracting finance flows including institutional money, retail and pension fund investment via passive and active fund strategies.

There is currently no control at the point of listing over whether the applicant company: (a) has a credible plan in place to reduce its climate impact as required by climate science and accepted emissions pathways to achieve the temperature goals of the Paris Agreement; or (b) whether the proceeds from listing will be used to fund activity which is known to be fundamentally inconsistent with such emissions pathways (such as investment in new oil and gas development).[1]

The FCA as UK Listing Authority (**UKLA**) has a range of powers and discretions which can be invoked in to protect investors and the financial markets, including the ability to refuse or place conditions on a listing on investor protection grounds, but these powers have rarely been used. Such powers could be invoked in a climate context, but we understand that this is not currently anticipated.

Allowing the listing of climate-exposed companies without appropriate controls and conditions is inconsistent with: (a) climate science and the goals of the Paris Agreement; (b) UK climate commitments, (c) investors' interests; and (d) the FCA's objectives.

Given the urgency of a comprehensive financial regulatory effort to mitigate the financial sector's contribution to the climate crisis, it is essential that the FCA's approach to listings is reformed, and a clear signal sent to the market that the FCA will take robust action on climate risk. If climate-exposed companies are nevertheless permitted to list without sufficient scrutiny and conditions being imposed by the FCA, ClientEarth's view is that there would be grounds for legal challenge to the listing.

Before explaining each of these issues in more detail, we have provided some information on recently planned or completed listings within and outside the UK to demonstrate the urgency of this issue.

Neptune energy (and other examples)

Neptune Energy (**Neptune**) is an oil and gas exploration and production category owned as to 51% by private equity (CVC and The Carlyle Group) and as to 49% by China's sovereign wealth

[1] Under the International Energy Agency's (**IEA**) net zero by 2050 scenario, no new oil and gas development is required beyond 2021. See IEA, Net Zero by 2050 – A Roadmap for the Global Energy Sector, May 2021, here.

fund, China Investment Corporation.[2] It was reported in May 2021 that Neptune had appointed financial adviser Rothschild & Co to explore potential liquidity options including a UK initial public offering (**IPO**) at a potential valuation of more than USD$5 billion, making it one of the largest listings of a pure-play oil and gas explorer and producer for several years.[3] If Neptune was to list in the UK, it would likely be within the FTSE 100.[4]

More recent reports from November 2021 suggest that private divestment options other than IPO are being considered by the owners[5]. However, there are widespread suggestions that rising oil and gas prices may lead to a broader revival of interest in oil and gas IPOs during 2022.[6]

It has recently been reported that North Sea energy company Ithaca Energy (**Ithaca**) intends to list on the LSE during 2022.[7] Ithaca is a subsidiary of Israeli energy conglomerate Delek Group which in April 2022 purchased private equity-backed Siccar Point Energy (**Siccar**) for $1.1 billion. Siccar holds a significant (70%) stake in the controversial[8] Cambo oilfield. Shell (which holds the remaining 30% stake in Cambo) in December 2021 announced its abandonment of the project[9] on the basis that "*the economic case for investment in this project is not strong enough at this time, as well as having the potential for delays*." Ithaca, however, has pledged to develop Cambo and the nearby Rosebank oil field.[10]

Other examples within and outside the UK include:

- Vår Energi, a pure play oil exploration and production spin out from Italy's Eni, floated on Euronext Oslo at a valuation of USD$7.85 billion in February 2022, making it the third-largest entrant to the Norwegian stock market of all time[11]; and
- In July 2021, North Sea oil company Orcadian Energy raised GBP£3 million on admission to the UK's Alternative Investment Market (**AIM**)[12].

[2] Slide 4 of Neptune's 2022 Company Overview Presentation: https://www.neptuneenergy.com/sites/neptuneenergy-corp/files/investor/reports-and-presentation/2022/FY%20results%202021/Company%20Overview%20-%20March%202022.pdf.
[3] Energy Voice, Neptune Energy working with Rothschild as it studies IPO (19 May 2021): https://www.energyvoice.com/markets/323953/neptune-energy-working-with-rothschild-as-it-studies-ipo/.
[4] The Times, Ex-Centrica chief Sam Laidlaw readies gas giant Neptune for £7bn float (23 May 2021): https://www.thetimes.co.uk/article/ex-centrica-chief-sam-laidlaw-readies-gas-giant-neptune-for-7bn-float-hd56q3cnc.
[5] Offshore Technology, Neptune Energy owners explore divestment (25 November 2021): https://www.offshore-technology.com/news/neptune-sell-energy-firm-5bn/.
[6] See, for example, Energy Voice, 'Uptick' in North Sea IPOs forecast with high oil and gas prices on course to continue (21 February 2022): https://www.energyvoice.com/oilandgas/north-sea/388737/uptick-in-north-sea-ipos-forecast-with-high-oil-and-gas-prices-on-course-to-continue/.
[7] https://www.reuters.com/business/energy/north-sea-energy-group-ithaca-buys-siccar-point-energy-ahead-ipo-2022-04-07/.
[8] https://foe.scot/press-release/cambo-billion-pound-gamble-risks-our-collective-safety/.
[9] https://www.bbc.co.uk/news/uk-scotland-59608521.
[10] https://www.bbc.co.uk/news/uk-scotland-north-east-orkney-shetland-61031088.
[11] Offshore Engineer, Vår Energi Shares Drop after $7.9B Eni Spin-off (16 February 2022): https://www.oedigital.com/news/494363-v-r-energi-shares-drop-after-7-9b-eni-spin-off.
[12] The Press and Journal, North Sea Orcadian raises £3million in AIM IPO (16 July 2021): https://www.pressandjournal.co.uk/fp/business/3316369/north-sea-orcadian-raises-3million-in-aim-ipo/.

The examples illustrate the gravity and relevance of the issue in the UK market, and the urgency of FCA action and guidance on this topic.

(a) Climate science

Such listings, unless the applicant companies can demonstrate that their business plans are aligned with credible emissions pathways to achieve the 1.5°C temperature goal of the Paris Agreement, are incompatible with the latest and best climate science.

The UN Intergovernmental Panel on Climate Change's (**IPCC**) October 2018 *Special Report on Global Warming of 1.5°C* set out the deep and widespread impacts which an increase in the global average temperature of 1.5°C would be likely to cause, and highlighted the significant differential in impacts between 1.5°C and 2°C of global average warming. Limiting global warming to 1.5°C is still technically feasible, but requires "*rapid, far-reaching and unprecedented"* changes in all aspects of society and the economy.[13]

The global commitment to limiting the "*increase in the global average temperature to well below 2°C above pre-industrial levels*" and to pursue "*efforts to limit the temperature increase to 1.5°C above pre-industrial levels*" is enshrined in the 2015 Paris Agreement, alongside the "net zero" goal of achieving a balance between emissions and removals of human-caused greenhouse gases (**GHGs**) in the second half of the century, where the emission of GHGs from sources is equally offset by their removal by sinks.[14] It is widely recognised that in order to limit warming to "well below 2°C", the second objective of global net zero emissions must be achieved *before* the second half of the century (i.e. by 2050, with absolute emissions halving between now and 2030).

The International Energy Agency's (**IEA**) authoritative Net Zero 2050 scenario, published in May 2021, highlights the scale and pace of changes needed in policy, technology and industry for the energy sector to reach net zero emissions by 2050, including the fact that no new fossil fuel developments are required beyond those already approved in 2021, and a cessation of the sale of petrol and diesel cars by 2030. Reaching net zero by 2050 would also require phasing out all unabated coal-fired power generation in advanced economies by 2030, and worldwide by 2040.[15]

More recently, the IPCC has confirmed that projected CO2 emissions from existing and planned fossil fuel infrastructure (without additional abatement) will exceed levels consistent with pathways that limit global warming to 1.5°C with no or limited overshoot[16] and that global GHG emissions must peak by 2025 at the latest to limit global warming to 1.5°C with no or limited overshoot[17]. The implication is that many proven fossil fuel reserves must be left in the ground if the world is to stand any chance of meeting its climate goals. A recent study has suggested that in order to limit global warming to 1.5°C, up to 40% of fossil fuel reserves currently under development will need to be left in the ground.[18] NGO Carbon Tracker, in its June 2022 update to its seminal "Unburnable Carbon" study, concludes that up to 90% of fossil fuel reserves must

[13] IPCC Special Report: Global Warming of 1.5C (Summary for Policymakers) (2018) here.
[14] United Nations, Paris Agreement, 2015 here. See articles 2(1)(a) and 4(1).
[15] IEA, Net Zero by 2050 – A Roadmap for the Global Energy Sector, May 2021, here.
[16] See the IPCC AR6 Summary for Policy Makers at B.7.
[17] See the IPCC AR6 Summary for Policy Makers at C.1.
[18] See 'Existing fossil fuel extraction would warm the world beyond 1.5 °C' (Trout et al., 17 May 2022, Environ. Res. Lett. 17).

remain in the ground.[19] Carbon Tracker also shows that, as has been the case since 2011, there are already more fossil fuels listed on the world's capital markets than the world can afford to burn if it is to prevent dangerous climate change.[20] According to Carbon Tracker, the discovered reserves and resources of companies with a public listing exceed the remaining carbon budget to limit global warming to (by more than three times), and are similar to the entire remaining budget to limit warming to 2°C. The total carbon potential of all known fossil fuel reserves is estimated to be over ten times the remaining carbon budget.[21]

The LSE is particularly exposed – the emissions embedded on the LSE are 30 times greater than those of the UK's own fossil fuel reserves, and ten times the UK's carbon budget for 2023-2037.[22]

A key implication of these findings is that fossil fuel company business plans that countenance any investment in new coal, oil or gas exploration and development and / or increases in supply are completely incompatible with the latest climate science and related temperature pathways. Additionally, company business models not predicated on new exploration and development, may nevertheless be incompatible with climate science and the temperature goals of the Paris Agreement if they do not commit to a reduction in absolute emissions (including Scope 3) at the rate required by their applicable emissions pathway.

Moreover, the *funding* by financial institutions of the development of new fossil fuel reserves or new coal-fired power generation (directly through project finance or indirectly through the provision of corporate financing for companies which undertake these activities) is incompatible with climate science.[23] If finance flows in the UK financial sector are to be aligned with global climate goals, they must be channelled away from such activities.

(b) UK Climate commitments

The UK is a signatory to the Paris Agreement, pursuant to which it has submitted an updated nationally determined contribution (**NDC**)[24] committing to reducing economy-wide greenhouse gas emissions by at least 68% by 2030, compared to 1990 levels. In its sixth carbon budget under the Climate Change Act 2008, the UK Government committed to reduce emissions by 78% by 2035 compared to 1990 levels, including aviation and shipping emissions.[25]

At COP26 in Glasgow, the UK committed to the Glasgow Climate Pact, which reaffirms the goals of the Paris Agreement, recognises that the impacts of climate change will be lower at a temperature increase of 1.5°C, notes that each increment in temperature increases the impacts

[19] See Carbon Tracker, Unburnable Carbon: Ten Years On (June 2022): https://carbontracker.org/reports/unburnable-carbon-ten-years-on/.
[20] See Carbon Tracker (2022) at footnote 19 and Carbon Tracker, Unburnable Carbon (July 2011): https://carbontracker.org/reports/carbon-bubble/.
[21] See Carbon Tracker (2022) at footnote 19.
[22] See p.12 of Carbon Tracker (2022) at footnote 19.
[23] See Oxford Sustainable Finance Group, Smith School of Enterprise and the Environment, University of Oxford, Implications of the International Energy Agency Net Zero Emissions by 2050 Scenario for Net Zero Committed Financial Institutions (2022).
[24] Available here.
[25] https://www.gov.uk/government/news/uk-enshrines-new-target-in-law-to-slash-emissions-by-78-by-2035.

of climate change and calls upon parties to transition towards low-emission energy systems, including through a phase-down of unabated coal power.[26]

At COP26, the UK also announced its ambition to be the world's first Net Zero-aligned Financial Centre, meaning: (i) that UK financial institutions and listed companies will be required to have "*a robust firm-level transition plan setting out how they will decarbonise as the UK meets its ambitious and legally binding net zero targets*"; and (ii) "*strong Government oversight of the financial sector as a whole to ensure financial flows actually shift towards supporting net zero*".[27] The government is planning to require publication of transition plans by asset managers, regulated asset owners and listed companies, and has established a Transition Plan Taskforce (**TPT**) administered by E3G and the Centre for Greening Finance and Investment to set a "gold standard" for transition plans.[28]

As noted above, the emissions already embedded on the LSE are 30 times greater than those of the UK's own fossil fuel reserves, and ten times the UK's carbon budget to 2037. Allowing additional climate-exposed companies (especially those committed to or planning new fossil fuel development) to list and access capital in the UK without appropriate controls and conditions is completely incompatible with the commitment to align financial flows to net zero.

If additional climate-exposed companies list on the LSE, and the bias towards fossil fuel and other climate-exposed companies of mainstream equity market indices such as the FTSE100 increases, investors will inadvertently increase their financing fossil fuel companies, in direct contravention of their financial best interests and potentially their sustainability preferences.[29] This is an 'automatic' consequence of passive funds which allocate against the relevant index adjusting their allocations to bring the new company into their portfolio.[30] Many of the investors trapped in such a situation may have very limited visibility or choice over the portfolio through their pension platform. This outcome directly contravenes efforts to protect investors from climate-related risks and help them invest in line with their sustainability preferences, and the need to align all corners of the financial system with net zero.

(c) Investor interests

Climate-exposed listings would also be against the interests of investors, who would be further exposed to the financial risks associated with investment in non-Paris-aligned fossil fuel expansion and inadvertently contribute to continued fossil fuel extraction around the world.

Fossil fuel businesses are particularly vulnerable to economic transition risks during the shift to a net zero economy, arising from: policy constraints, technological trends, market forces and

[26] https://unfccc.int/sites/default/files/resource/cop26_auv_2f_cover_decision.pdf.
[27] This aligns with the Paris Agreement aim of "*making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development*." See Article 2(1)(c).
[28] https://www.gov.uk/government/publications/fact-sheet-net-zero-aligned-financial-centre/fact-sheet-net-zero-aligned-financial-centre.
[29] See for example: https://ieefa.org/ieefa-report-blackrocks-fossil-fuel-investments-wipe-us90-billion-in-massive-investor-value-destruction/; and https://ieefa.org/wp-content/uploads/2021/06/Vanguard-Group_Passive-About-Climate-Change_June-2021.pdf.
[30] See InfluenceMap, Who Owns the World's Fossil Fuels (December 2018) for commentary on this trend: https://www.gov.uk/government/publications/automatic-enrolment-evaluation-report-2019/automatic-enrolment-evaluation-report-2019#impact-of-automatic-enrolment-on-individuals-and-saving.

reputational / competitiveness risks relating to their social licence to operate. The related concept of "stranded assets" is well documented. A "stranded asset" cannot viably be exploited for the value, or for the life for which it was expected to be utilised, which negatively impacts on its current value.

In 2019, for example, Carbon Tracker estimated the major oil and gas companies need to reduce production by 35% to 2040 to stay within their carbon budgets.[31] This creates risk for investors in such companies as continuing to implement a business plan that does not acknowledge this reality will destroy shareholder value by creating stranded assets, i.e. investing in fossil fuel reserves that cannot be burned economically. Carbon Tracker's recent modelling suggests that over $1 trillion of oil and gas assets risk being "stranded", $600 billion of which is held by listed companies.[32] The LSE already has 59 listings of oil and gas producers and the third largest projected oil and gas project capital expenditure (after New York and Moscow), making London particularly exposed to this transition risk.[33]

Allowing additional climate-exposed companies that have concentrated exposure to this risk to list and access capital on UK markets without demonstrating that they have a Paris-aligned transition plan in place exposes investors to unnecessary additional financial risk. If adequate disclosure of such risks and the company's response to them is not provided at the time of listing, this also creates a material information gap for investors which makes it impossible to reach an informed judgement about the value of the investment. As a result, there is a risk that investors are misled.

Investors have demonstrated unequivocally and repeatedly that information about the climate risks facing a company, the company's plan to address such risks, and the financial implications of such risks and plans is material to them, and should feature in both the company's narrative reporting and its financial statements.[34] It is incumbent upon the FCA to address these omissions to protect the integrity of the listing process.

(d) FCA objectives

For all of the reasons given above, allowing such listings to proceed without requiring applicants to demonstrate Paris-alignment would also conflict with the FCA's strategic objective (to ensure markets function well[35]), its operational objectives to secure appropriate protection for consumers and protect the integrity of the UK financial system[36], and its regulatory principles, including the sustainable growth principle.[37] In contrast, requiring climate-exposed applicants to demonstrate

[31] See Carbon Tracker, Balancing the Budget (November 2019): https://carbontracker.org/reports/balancing-the-budget/.
[32] See p.13 of Carbon Tracker (2022) at footnote 19.
[33] See p.36-38 of Carbon Tracker (2022) at footnote 19.
[34] See, for example, The IIGCC's Investor Expectations for Paris-aligned Accounts (November 2020): https://www.iigcc.org/download/investor-expectations-for-paris-aligned-accounts/?wpdmdl=4001&masterkey=5fabc4d15595d; and the UN PRI's Investor groups call on companies to reflect climate-related risks in financial reporting (September 2020): https://www.unpri.org/accounting-for-climate-change/investor-groups-call-on-companies-to-reflect-climate-related-risks-in-financial-reporting/6432.article.
[35] Section 1B(1) FSMA.
[36] Set out in s.1B(3) FSMA.
[37] Section 3B(c) FSMA.

Paris-alignment as a condition of listing, and the other steps recommended in this position paper would be consistent with the FCA's applicable objectives and principles.

In addition, the FCA is required to have regard to the recommendations made to it by HM Treasury when considering how to discharge its objectives and apply its principles. The 2021 remit letter from HM Treasury to the FCA stipulated that the FCA should have regard to the Government's commitment to achieve net zero by 2050 when discharging its functions and take into account the Government's desire to support sustainable economic growth and facilitate finance for clean investments.[38] This requirement was reinforced in the 2022 remit letter from HM Treasury to the FCA, alongside a requirement for the FCA to have regard to the UK's Energy Security Strategy "*where practical and relevant*".[39]

The FCA's objectives and principles should be interpreted in light of this remit, and the FCA will need to consider how to interpret its remit in situations where the assumptions made in the UK's Energy Security Strategy appear to conflict with the requirements of climate science and the UK's climate commitments. In our view, pending the adoption by the UK Government of a credible plan for the managed phase out of North Sea oil and gas production, ensuring the proper functioning of the UK financial markets and the protection of consumers require that the fundamental requirements of climate science and the UK's legally binding climate commitments must be prioritised by the FCA in such situations, owing to the systemic financial risks associated with investment in assets which will become stranded in the global transition to net zero, and evidence that continued investment in new fossil fuel supply is not the best way to achieve energy security. We would be delighted to discuss this further with the FCA.

<u>The relevance of recent energy price volatility</u>

We note that there have been some recent suggestions that volatile oil and gas prices mean that it is in consumer interests to invest in new domestic oil and gas supply. However, in relation to recent volatile oil and gas prices, the UK's own Climate Change Committee (**UKCCC**) has stated in February 2022 that "*The best way of reducing the UK's future exposure to these volatile prices is to cut fossil fuel consumption on the path to Net Zero – improving energy efficiency, shifting to a renewables-based power system and electrifying end uses in transport, industry and heating. Any increases in UK extraction of oil and gas would have, at most, a marginal effect on the prices faced by UK consumers in future*."[40]

UN Secretary General Antonio Guterres has reached a similar conclusion, stating that *"new funding for fossil fuel exploration and production infrastructure is delusional"* and would worsen climate change and pollution, and also stating: *"Had we invested massively in renewable energy in the past, we should not be so dramatically at the mercy of the instability of fossil fuel markets now".*[41]

[38] See https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/972445/CX_Letter_-_FCA_Remit_230321.pdf.
[39] See https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1067014/Recommendations_for_the_Financial_Conduct_Authority_April_2022_final.pdf.
[40] https://www.theccc.org.uk/publication/letter-climate-compatibility-of-new-oil-and-gas-fields/.
[41] Reuters, <u>UN chief says new fossil fuels is delusional</u> (2022).

2. Available FCA powers

The FCA's role in the listing process provides it with a range of existing powers through which it can act today to mitigate the risks associated with the listing of climate-exposed companies on the main market of the LSE.

The relevant powers of the FCA include:

- the FCA's power to refuse permission for listing, or impose conditions, on investor protection grounds;
- the option to treat listing transactions as "high risk", making them subject to heightened scrutiny during eligibility review;
- control over prospectus approval; and
- oversight of sponsors.

These powers are sufficient for the FCA to take a range of measures identified in **Section 3**.

A company seeking admission to trading on the Main Market of the LSE must:

(a) apply to the FCA for admission to the Official List, meeting specific eligibility criteria set out in the Listing Rules (**LRs**) to the FCA's satisfaction;

(b) apply to the London Stock Exchange for admission to trading in accordance with the LSE's Admission and Disclosure Standards; and

(c) publish a prospectus approved by the FCA in accordance with the FCA's Prospectus Regulation Rules.

After the issuer applies for admission to the Official List, the FCA will undertake an **eligibility review**[42] to determine whether the issuer's securities are eligible for a listing, in parallel with the FCA's review of the company's prospectus. The FCA may not grant admission to listing unless it is satisfied that: (1) the requirements of the LRs have been complied with; and (2) any special requirements specified by the FCA are satisfied.[43]

Within this process, the FCA has access to a range of powers which enable it to intervene effectively to mitigate climate risk, including those described below.

[42] In December 2019, the FCA published a Primary Market Procedural Note providing guidance to issuers on the eligibility review process, available here: https://www.fca.org.uk/publication/primary-market/pn-901.4.pdf.
[43] See LR 2.1.2G and s.75(4) FSMA.

(i) Investor protection discretion to refuse or place conditions on an application for listing

Under its existing powers, the FCA may:

(a) refuse an application for listing if it considers that the admission of securities would be detrimental to investors' interests[44]; or

(b) make the admission of securities to the Official List subject to any special requirement that it considers appropriate to protect investors.[45]

Although we are not aware of any publicly available examples of the FCA exercising its discretion to refuse a listing on investor protection grounds, this power is theoretically broad enough for the FCA to impose conditions on their approval of a listing which are designed to protect investors from unmitigated climate-related financial risk. The FSA, as the FCA's predecessor as UKLA, has indicated[46] that the investor detriment grounds for refusing or placing conditions on a listing carries a high materiality threshold, but we consider that this is met in relation to the systemic financial risks posed by climate change.

(ii) Heightened scrutiny of "high risk" transactions during eligibility review

When the FCA identifies an application for listing as a transaction carrying a high risk of investor detriment, it is able to apply heightened scrutiny during the eligibility review process, making additional enquiries of issuers and sponsors in order to ensure that the FCA is able to decide whether such a listing would be detrimental to investors on a fully informed basis, and satisfy itself as to the rigour of the due diligence work carried out by the sponsor.[47]

For example of how this is applied in practice, the FCA has indicated, in a primary market bulletin[48] and proposed technical note[49] that it will treat applications for listing from applicants with cannabis-related businesses as high risk, and will conduct additional due diligence during eligibility review for such applicants accordingly.

Although the FCA's approach to cannabis-related businesses is largely driven by concerns relating to illegality under the Proceeds of Crime Act 2002 (**POCA**) (which are less likely to be relevant in the context of a fossil fuel company listing), the approach provides a useful template of the heightened scrutiny which should apply to fossil fuel company listings.

[44] See LR 2.1.3G and s.75(5) FSMA.
[45] See LR 2.1.4R(1) and s.75(4)(b) FSMA. The FCA must inform the issuer of any special requirements imposed (LR 2.1.4R(2)).
[46] See pages 1-2 of UKLA Publications Technical Note: Listing Rules (FSA, October 2010), although note that this technical note is not included in current FCA / UKLA guidance: https://webarchive.nationalarchives.gov.uk/ukgwa/20101011114922/http:/www.fsa.gov.uk/pubs/ukla/listing_rules.pdf.
[47] See the FSA technical note referred to in footnote 46.
[48] Primary Market Bulletin 35 (FCA, July 2021): https://www.fca.org.uk/publications/newsletters/primary-market-bulletin-35/printable/print.
[49] Proposed Primary Market Technical Note 104.1 (FCA, draft published for consultation July 2021): https://www.fca.org.uk/publication/ukla/fca-tn-104.1.pdf.

(iii) Control over prospectus approval

During the listing process, the FCA has control over the approval of the prospectus prepared by the issuer. FCA may not approve a prospectus unless satisfied that the prospectus contains all required information and satisfies all of the other requirements of the Prospectus Regulation Rules (**PRRs**) and the Financial Services and Markets Act 2012 (**FSMA**).[50] The specific climate risks and impacts faced by an issuer are relevant to many of these requirements.

Relevant requirements include:

(a) The "general disclosure requirement" for the prospectus to contain the information necessary for an investor to make an informed assessment of: (a) the assets, liabilities and financial position and prospects of the issuer; (b) the rights attaching to the issued securities; and (c) the reasons for the issuance and its impact on the issuer.

(b) The specific disclosure requirements applicable to the issuer and its securities, which may include: (a) risk factors; (b) any environmental issues which may affect the issuer's utilisation of its tangible fixed assets; (c) a description of the issuer's operating environment, together with information regarding any governmental, economic, fiscal, monetary or political policies or factors that have materially affected, or could materially affect, directly or indirectly, the issuer's operations; and audited historic accounts covering the last three financial years.[51]

(c) The format requirements applicable to each element of the prospectus[52], such as the requirement for the summary to be accurate fair, clear and not misleading and consistent with the rest of the prospectus.[53]

(d) Specific "mineral company" disclosure requirements which apply to fossil fuel companies, mining companies and others.[54] These include details of the company's mineral resources, reserves and exploration results / prospects to be disclosed in accordance with specified reporting standards; the anticipated duration of commercial activity / extraction of reserves and any related licences or concessions; current progress in relation to each project; and an explanation of exceptional factors influencing these disclosures.

Through its review and approval of the prospectus, the FCA has the power and opportunity to ensure that any climate related risks and impacts faced by the company, including the implications of transition to a net zero emissions economy by 2050, are adequately reflected in the various prospectus disclosures made by the applicant. If utilised, this power would protect investors, and the stability of the market, by ensuring that investment decisions are fully informed and that climate risk does not go unreported at the point of listing.

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[50] See s.87A FSMA and PRR 1.2.1.
[51] See Annex 1 to the UK version of Commission Delegated Regulation (EU) 2019/980 (**UK Prospectus Delegated Regulation**).
[52] Generally consisting of a summary, a registration document and a securities note.
[53] Articles 7(1) and 7(2) of the UK version of the Prospectus Regulation (EU) 2017/1129 (**UK Prospectus Regulation**).
[54] See Article 39 of and Annex 29 to the UK Prospectus Delegated Regulation, and the FCA's Primary Market Technical Note TN619.1, available at: https://www.fca.org.uk/publication/primary-market/tn-619-1.pdf.

(iv) Oversight of sponsors

As participants in the listing process, sponsors have a huge amount of responsibility for how an applicant's case for listing is presented to the FCA, through advising the applicant on the listing process and facilitating communications with the FCA. One of the sponsor's key roles is to provide a "sponsor's declaration" to the FCA, confirming that:

(a) the sponsor is satisfied that (among other things):

  (i) the applicant has met the requirements for listing[55];

  (ii) the directors have established procedures which provide a reasonable basis for them to make judgements about the company's financial health and prospects, and enable the company to comply with the ongoing obligations applicable to listed companies[56]; and

(b) the sponsor has acted with due care and skill in the provision of sponsor services[57]; and

(c) all matters known to the sponsor which should be taken into account by the FCA in considering: (a) the application for listing; and (b) whether the admission of the securities would be detrimental to investor interests, have been disclosed with sufficient prominence in the prospectus or equivalent document or otherwise in writing to the FCA[58].

The FCA has oversight of the authorisation of institutions as sponsors and the duties applicable to them once they are authorised. To become a sponsor, a person must apply to the FCA for approval and meet certain criteria including being competent to perform sponsor services and having appropriate systems and controls in place to ensure it can carry out its role as sponsor in accordance with the relevant LRs.[59]

In relation to companies operating in specialist sectors such as oil and gas companies, the FCA expects competent sponsors to be aware of "*the specific guidance or rules for specialist industry sectors, the particular challenges or risks that a sector may face, and the impact these may have on eligibility, document disclosure and/or continuing obligations of their client*."[60] The FCA has also acknowledged, in relation to the recent introduction of LR 9.8.6R(8), that climate change may affect the duties of the sponsor during the listing process and that sponsors may need to enhance their knowledge and experience of climate-related financial disclosures alongside the work they carry out in relation to the company's other continuing obligations.[61]

The FCA's oversight of sponsors provides a valuable opportunity to ensure that sponsors factor the risks and impacts associated with climate change into their engagements with climate-exposed companies, and have the necessary skills and expertise to do so.

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[55] LR 8.4.2R(1) and (2).
[56] LR 8.4.2R(3).
[57] See LR 8.3.3.
[58] This confirmation relates to the requirement in LR 8.4.3R(3).
[59] See LR 8.6.7R.
[60] See UKLA Technical Note, Sponsors: guidance on the competence requirements set out under LR 8.6.7R(2)(b) (March 2017): https://www.fca.org.uk/publication/ukla/tn-714-2.pdf.
[61] See page 27 of PS20/17, available here: https://www.fca.org.uk/publication/policy/ps20-17.pdf.

3. ClientEarth's specific recommendations for the FCA

Our specific recommendations as to how the FCA should use its powers to mitigate the climate-related risks identified in this position paper are as follows:

1. **Paris-alignment condition**. The FCA should use its investor protection discretion to make demonstrable Paris-alignment (through having a credible transition plan) a condition of listing for climate-exposed / carbon-intensive companies (including, in particular, thermal coal and oil and gas companies), and refuse application for listing from such a company that cannot demonstrate that it is Paris-aligned to the FCA's satisfaction.

2. **Heightened scrutiny during eligibility review**. The FCA should treat such listings as "high-risk" transactions and apply heightened scrutiny (i.e. additional due diligence on climate-related risk) during the eligibility review, as a matter of course.

3. **Technical guidance**. The FCA should confirm its position and send a clear signal to the market by issuing authoritative guidance covering:

    a. The requirement for new applicants to demonstrate Paris-alignment;
    b. The FCA's approach to heightened scrutiny of applicants during eligibility review;
    c. The FCA's approach to climate change risk during prospectus review; and
    d. The FCA's expectations of sponsors in relation to climate change risk.

1. Paris-alignment condition

Core requirements

The FCA should make approval of an application for listing by a climate-exposed company conditional on the company demonstrating that its business plan and operations are consistent with an emissions trajectory aligned with the 1.5°C temperature goal of the Paris Agreement, and that the proceeds of listing will not be used to fund activities which are known to be inconsistent with the Paris Agreement (including new fossil fuel development).[62]

Alignment would be demonstrated by presentation / disclosure of a credible transition plan assessed against the requirements of climate science, the Paris Agreement and best practice standards for net zero target setting and transition planning.

Acknowledging the wide variety of frameworks and methodologies used to set net zero targets and transition plans, "credibility hallmarks" of a robust transition plan should be identified to

[62] Though it is not the main focus of this position paper, it is also our view that Paris-alignment should be a pre-requisite for subsequent issuances of equity and debt after a company has listed. These funding options should not be available to finance activity which is incompatible with the Paris-agreement and exposes investors to unnecessary climate-related financial risk.

assess and compare companies' approach to net zero. There exist a variety of frameworks which could provide a comparison point against which to gauge the adequacy of a company's transition plan, to a greater or lesser degree of sophistication, to which the FCA should have regard.[63] The new requirement should also be developed by reference to efforts of the Transition Plan Taskforce in setting the "gold standard" for transition plans, and would be consistent with the broader regulatory workplan of the FCA in this area.

- To give a non-exhaustive indication, credibility hallmarks could include:
  - A Paris-aligned net zero 2050 emissions objective covering Scope 1-3 emissions (including end use from fossil fuels).
  - Short, medium and long term absolute emissions reduction targets in line with the applicable sectoral emissions pathway, including interim 5 yearly (or more frequent) targets.
  - No inappropriate reliance on 'offsets' in place of genuine absolute emissions reductions.
  - A detailed plan regarding how targets will be met, including phase out of thermal coal and dramatic phase down of oil and gas (as applicable). Investments in unabated thermal coal, or new exploration or development of oil and gas, which are inconsistent with credible net zero pathways, would be ruled out by the plan.
  - Disclosure of underlying methodologies and risk factors to delivery of the plan.
  - Allocation of board level and management responsibility to specific individuals.
  - Consistency with capex plans, broader financial reporting, lobbying and remuneration.

Implications for carbon-intensive issuers

Imposing a Paris-alignment condition on new listings of climate-exposed / carbon-intensive companies would be a proportionate measure to protect investors and entirely consistent with existing ongoing TCFD disclosure requirements for listed companies, and the intention to make transition plans mandatory in the UK.

[63] Reference points could include:
- SBTi's cross-sector pathway: https://sciencebasedtargets.org/resources/files/Net-Zero-Standard.pdf;
- ClientEarth's Principles for Paris-Alignment: https://www.clientearth.org/media/40omeroa/2020-10-16-principles-for-paris-alignment-position-paper-ce-en.pdf;
- Relevant Disclosure Indicators from within the CA100+ Net Zero Company Benchmark: https://www.climateaction100.org/wp-content/uploads/2021/03/Climate-Action-100-Benchmark-Indicators-FINAL-3.12.pdf;
- CIFF's Essential components of a corporate climate action plan: https://sayonclimate.org/wp-content/uploads/2021/09/How-to-evaluate-a-climate-plan_evaluation-criteria-010721_public.pdf;
- The guidance on transition plans included in TCFD's 2021 guidance on metrics, targets and transition plans: https://assets.bbhub.io/company/sites/60/2021/07/2021-Metrics_Targets_Guidance-1.pdf; and
- Guidance issued by GFANZ in 2022 on financial institution transition plans: https://assets.bbhub.io/company/sites/63/2022/06/GFANZ_Recommendations-and-Guidance-on-Net-zero-Transition-Plans-for-the-Financial-Sector_June2022.pdf.

This requirement would not amount to an outright ban on fossil fuel listings (or the listing of companies operating in any other climate-exposed sector), but would incentivise such companies to transition their business models as required under credible emissions pathways to achieve the 1.5°C temperature goal of the Paris Agreement, as this would be a condition of access to capital. In many cases, companies would be required set out a robust plan to dramatically reduce their emissions (Scopes 1-3 including the end use of fossil fuels where relevant) in order to meet this requirement, in line with the need to reduce absolute emissions 50% by 2030. In this sense, the Paris-alignment condition could become a key lever to aligning the UK financial system with the UK's climate commitments by proactively incentivising transition in the real-economy.

It should, however, be noted that, under a suitably rigorous framework, it would not be possible for a climate-exposed company to meet this condition without undertaking that the proceeds of the listing would not fund (directly or indirectly) any activities known to be fundamentally incompatible with the Paris-agreement, including new fossil fuel development. Again, this is justified to protect investors, as companies listed on the LSE already hold fossil fuel reserves which cannot be extracted – there can be no justification for the UK financial sector to facilitate the funding of more reserves which cannot be economically extracted.

We acknowledge that implementing a Paris-alignment condition may result in some applications for listing by climate-exposed companies being declined. In ClientEarth's view, this would be an acceptable outcome given the investor protection benefits of: (a) ensuring that new applicants have developed transition plans and business strategies that future-proof them for the transition to a low-carbon economy; (b) preventing finance flowing into companies whose business models exacerbate the climate crisis (and the systemic risks associated with it); and (c) proactively incentivising transition in the real-economy.

FCA powers and enforcement

Imposing a condition of this nature would be within the FCA's existing power to make the admission of securities to the Official List subject to any special requirement that it considers appropriate to protect investors (which is explained in more detail above). Although the FSA (as the FCA's predecessor) has indicated in guidance that the exercise of this power carries a high materiality threshold, the systemic financial risks posed by climate change justify the use of this power.

We recognise, however, that in order to send a clear signal to the market regarding this requirement, the FCA may prefer to develop and introduce a new specific rule.

Note that we are not suggesting that the FCA use its powers to immediately suspend or cancel existing listings on the basis of the relevant companies not being Paris-aligned. This is in acknowledgement of the potentially destabilising impact this could have on the functioning on the market, and the time issuers may need in order to develop credible transition plans under the new requirements.

We do, however, consider that the FCA should consider it's full range of enforcement powers (including the suspension or cancellation of a listing[64]) in cases where issuers are persistently failing to comply with the Listing Rules, including the required TCFD disclosures for premium and

[64] See s. 77 FSMA and LRs 5.1.1 and 5.1.2.

standard listed issuers, and mandatory transition plan disclosures, once they are introduced. Given widespread failings of listed companies to meet non-financial and financial disclosure requirements in relation to climate change[65], we urge the FCA to step up enforcement in relation to corporate reporting under both existing and new rules, and to police the quality of such disclosures, not just their existence.

2. Heightened scrutiny during eligibility review

The FCA should treat applications for listing by climate-exposed companies as “high risk” transactions subject to heightened scrutiny during eligibility review, in line with historic FSA guidance. The basis for this would be that the applicant company is subject to particularly acute climate-related financial risks which could materially affect the valuation and financial health of the company in a way that may not be fully captured in prospectus disclosures. In order to protect investors, it is incumbent on the FCA to assess the company’s approach to climate risk before approving the listing.

The high risk classification would require the FCA to consider whether the listing would cause investor detriment and would trigger a process of heightened scrutiny (i.e. due diligence) to determine this question. In this situation, the FCA should make additional enquiries of the issuer and the sponsor to decide on a fully informed basis whether there is investor detriment.

During the eligibility review, such enquiries would be made via the sponsor and would include enquiry into the procedures undertaken within the sponsor to ensure relevant requirements of the listing rules are met.

Topics of enquiry should include:

- Whether the company has in place a credible transition plan which is aligned with the Paris Agreement temperature goals, assessed against credibility hallmarks identified by the FCA (by reference to the work of the TPT).
- Whether the company has adequate procedures in place to substantiate its TCFD and transition plan disclosures on an ongoing basis after listing.
- How climate risk and the related financial implications have been reflected in the prospectus overall so that investors are presented with the necessary information to make an informed assessment of the financial position and prospects of the issuer, including in the risk factors, operating and financial review and regulatory environment disclosures. The following areas should be given specific attention:
    - Whether the company’s climate risk and related narrative disclosures are adequate to inform and not mislead investors of the material risks facing the company. This should include whether the company’s Scope 1-3 emissions and, where relevant, the company’s stranded asset risks have been transparently disclosed to investors.

[65] See https://www.clientearth.org/latest/documents/accountability-emergency-a-review-of-uk-listed-companies-climate-change-related-reporting-2019-20/.

        - If and how the company's climate risks, commitments and transition plans have been adequately reflected in historical financial information, revenue earning track record and working capital information provided in the prospectus.
        - Whether financial information disclosed by the company is based on assumptions aligned with the 1.5°C temperature goal of the Paris agreement or, if not, whether sensitivity to such assumptions has been transparently disclosed.[66]
    - How the sponsor has satisfied itself (including the procedures used, use of experts, engagement with directors, and level of sign off) that the issuer and its directors have appropriately addressed climate change risk in their compliance with the listing rules, and that the directors understand their ongoing obligations in relation to climate change risk.
    - Whether there is any other information known to the sponsor that should be disclosed to enable the FCA to make a fully informed decision on the application for listing.

This approach would be consistent with the approach taken by the FCA to listings of cannabis related businesses which, as noted above, are treated as high risk transactions on a basis explained to the market in FCA guidance.

3. Technical guidance

Finally, the FCA should issue clear technical guidance covering:

a. The requirement for new applicants to demonstrate Paris-alignment;

b. The FCA's approach to heightened scrutiny of applicants during eligibility review;

c. The FCA's approach to prospectus review; and

d. The FCA's expectations of sponsors in relation to climate change.

In doing so, the FCA would provide clarity to investors and issuers and demonstrate global leadership in its approach to harmful carbon-intensive businesses.

The guidance on **Paris-alignment** and **heightened scrutiny** would set out the FCA's approach to the issues described above.

Guidance on **Prospectus review** would set out the FCA's expectations for the reflection of climate change risk in prospectus disclosures, building on the ideas discussed in the FCA's December 2021 Technical Note on ESG and climate related disclosures.[67] The guidance would make it clear that the FCA expects climate-exposed companies to reflect climate risk in the following disclosures (and any other relevant disclosures) in order to provide investors with the information they need to make an informed assessment of the prospects of the issuer:

[66] Noting that investors have identified this information as material to their decision-making – see footnote 34.
[67] https://www.fca.org.uk/publication/ukla/fca-tn-801.2.pdf.

- risk factors;
- environmental issues affecting the issuer's utilisation of tangible fixed assets;
- the operating and financial review (including relevant KPIs);
- the description of the issuer's regulatory environment; and
- historic financial accounts.

Guidance on **the FCA's expectations of sponsors** would clarify the relevance of climate change to various aspects of the sponsor's role in relation to listing, including:

- the expectation for Sponsors to be "climate-competent" and demonstrate an understanding of how climate change affects the eligibility for listing of companies in exposed sectors[68];
- the use of climate experts by the sponsor and appropriate challenge of third-party input;
- the obligation to carry out sponsor services with due care and skill, including in respect of the impact of climate change on the issuer's eligibility and required disclosures[69];
- the systems and controls the sponsor is required to maintain in relation to climate change, including staffing expertise, training, supervision and sign off;
- the requirement to consider the impact of climate change in the assessment of whether the applicant company has met the requirements of the listing and prospectus rules[70];
- the impact of climate change on the adequacy of procedures put in place by the company directors to enable them to make proper judgements about the position of the company and enable the company to comply with its ongoing requirements once listed[71]; and
- the obligation to disclose climate-related matters to the FCA where those matters should be taken into account in the decision whether to approve an application for listing (in light of investor interest).[72]

This would be effective to clarify the obligations on sponsors to take account of climate change when they make representations to the FCA about the applicant during the listing process and encourage sponsors to develop their climate expertise.

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[68] In line with the requirement for sponsor employees to understand specialist industry sectors – see See LR 8.6.7R(2)(b)(v).
[69] See LR 8.3.3.
[70] LR 8.4.2R(1) and (2).
[71] LR 8.4.2R(3) and (4).
[72] See LR 8.4.3R(3).