BEIS Consultation: Mandatory climate-related financial disclosures

ClientEarth briefing

Top Lines

- Despite clear investor demand, companies in the UK consistently fail to disclose material climate-related information to financial markets – likely breaching the law.
- The BEIS proposals to enhance climate change-related disclosure obligations for publicly quoted companies, large private companies and LLPs are welcome, but inadequate – unless they are improved, the Government’s objectives of mitigating climate change-related risks for companies and investors and smoothing the transition to net-zero will not be achieved.
- To achieve its objectives, the Government must amend the proposed disclosure obligations to:
  o require companies to disclose against each of the 11 TCFD Recommended Disclosures;
  o require companies to disclose a ‘Paris-aligned’ strategy and financial accounts, with a credible plan for how they can achieve ‘net zero’ GHG emissions by 2050 (TCFD+);
  o make the proposed disclosure obligations mandatory in practice, not just in name, and avoid a confusing ‘comply or explain’ approach;
  o provide investors with an advisory vote at company AGMs on the adequacy of company climate change strategies and targets;
  o provide financial regulators with effective accountability and enforcement powers; and
  o require auditors to provide assurance in relation to these disclosures.
Background

It is now widely agreed that UK companies are failing to disclose material climate-related information.¹ This is despite clear and repeated assertions from investors, over many years, that consistent, comparable and high quality climate change-related information is highly material to their decision-making.² These continued disclosure failures undermine investors’ ability to integrate climate-related information into their investment and stewardship decisions, increase financial stability risks and delay action to align the economy and financial system with the Government’s ‘net-zero’ by 2050 target.³

ClientEarth welcomes the proposals from the Department of Business, Energy and Industrial Strategy (BEIS) to enhance climate change-related disclosure obligations for publicly quoted companies, large private companies and LLPs. However, in our view, in their current form, the proposals will fail to achieve their stated objectives. In order to provide investors, consumers and other stakeholders with the consistent, comparable and high quality climate-related information they need and expect, improvements must be made to the proposals in relation to content, application, accountability and enforcement.

In advance of preparing our more detailed response to the consultation, this briefing, sets out ClientEarth’s six key recommendations for improving the BEIS proposals. We welcome discussion on these matters and strongly encourage other stakeholders to consider and adapt these points in preparing their own responses to the consultation (due date: 5 May 2021).

Key Recommendations

1. Require companies to disclose against the eleven TCFD Recommended Disclosures

In the consultation document, BEIS asserts that it has aligned its proposals with the Task Force on Climate-related Financial Disclosures (TCFD) by requiring disclosures under the four pillars proposed by the TCFD (‘Governance’, ‘Strategy’, ‘Risk Management’ and ‘Metrics & Targets’). In its more detailed section on the proposed obligations, BEIS then suggests that companies will be required to disclose information under each of these headings, but proposes specific disclosure requirements, which vary significantly from the 11 TCFD Recommended Disclosures (see Questions 6 and 7). BEIS also specifically notes that one of the key TCFD Recommended Disclosures, relating to scenario analysis, will not be required (see Question 8). This approach would be a mistake. Companies must be required to disclose against the eleven TCFD Recommended Disclosures. This is because:

- the eleven Recommended Disclosures of the TCFD have become the base-line industry standard for disclosing material climate-related information, and are now widely used and understood;
- replacing the eleven Recommended Disclosures with new and different disclosure obligations, while asserting that they are nonetheless aligned with the TCFD, will create significant confusion

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³ Climate Change Act 2008.
for preparers and users and undermine existing market practice, guidance and consistency with disclosures in other jurisdictions;

- the TCFD Recommended Disclosure in relation to scenario analyses is not prescriptive about the level of detail of analyses that is required, allowing a proportionate approach to be taken, that will not place an undue burden on companies.

2. Require companies to disclose a ‘Paris-aligned’ strategy (TCFD+)

A mandatory requirement for companies to align their reporting with the Recommended Disclosures established by the TCFD is a necessary starting point to ensuring better quality climate-related disclosures. However, on its own, this will not be sufficient to provide the material information that investors now assert is relevant to their decision-making (see Question 7). In order to adequately meet investors’ current and emerging needs, BEIS must amend the proposal to additionally require companies to disclose a ‘Paris-aligned’ strategy and financial accounts, with a credible plan for how they can achieve ‘net zero’ GHG emissions by 2050 (to be referred to as TCFD+).\(^4\) This is because:

- the urgency of the climate emergency and escalating government action mean that investor information needs and company disclosures have evolved beyond the TCFD framework;\(^5\)
- investors are now demanding disclosures about companies’ strategic alignment with the Paris Agreement objectives, including sector specific short-medium term GHG emission reduction targets (Scopes 1-3), and capital expenditure plans and accounts aligned with these targets;\(^6\)
- unequivocal assertions by investors that such information is relevant to their investment and stewardship decision-making means that it is material for all companies and must be disclosed;\(^7\)
- failure to reflect this reality in the new disclosure obligations will cause confusion for companies, undermine investor efforts to secure material information to guide their decision-making, and create costly inconsistency with new EU requirements which will require such disclosures.\(^8\)

3. Make the proposed disclosure obligations mandatory

The title and introductory explanation in the consultation appear to convey an intention to make the new requirements to report in line with TCFD Recommendations ‘mandatory’. However, the actual contents of the consultation propose a far weaker ‘comply or explain’ approach, whereby a company can decide, at its own discretion, whether or not to provide the required disclosures (see Question 10). This weak approach to the application of the new obligations would be a mistake. Investors have been clear that detailed climate change-related information is material for all companies. Adopting a weak ‘comply or explain’ approach provides an excuse for companies to delay compliance, will waste investors’ time with arguments about materiality, and undermines effective accountability and enforcement by regulators. This would lead to slow implementation, lower quality disclosures with greater scope for ‘greenwash’;

\(^4\) For a ‘principles-based’ approach to such strategies, see, ClientEarth, ‘Principles for Paris-alignment’ (2020).
\(^6\) See UNFCCC, ‘Race to Zero’ (2020); UNEPFI, ‘Net-Zero Asset Owner Alliance’; Sarasin & Partners, ‘Paris-aligned accounting is vital to deliver climate promises’ (2020); Carbon Tracker, ‘When Capex met climate’.
\(^7\) See, eg, Climate Action 100+; S&P Global, ‘BlackRock voted against management at 53 companies over climate concerns’ (2020); Nest, ‘Nest going net-zero to support green recovery’ (2020).
and increased uncertainty for companies, investors, and consumers. The new disclosure obligations
must be introduced on a clear mandatory basis. This is because:

- investors expect issuers to use the TCFD recommendations to provide material climate-related
  information to satisfy existing disclosure requirements, and hundreds of companies now do so;9
- the TCFD recommendations are a principles-based framework, which provide flexibility for
  issuers to disclose in a proportionate way, so concerns about any undue burden are unfounded;
- existing laws protect companies and directors from frivolous or unfounded litigation for making
  good faith climate-related disclosures – conversely, a confusing ‘comply or explain’ approach
  may lead to material omissions, increasing legal risk and uncertainty.10

4. Provide investors with a ‘say on climate’ AGM vote

Alongside a new explicit requirement on companies to disclose a ‘Paris-aligned’ strategy and financial
accounts, the BEIS proposals should be updated to provide investors with an advisory vote at company
AGMs on the adequacy of company climate change strategies and targets.11 This is necessary to ensure
that such disclosures are fair, balanced, and credible and to mitigate the risks of ‘greenwashing’, which
are becoming an increasing concern for investors and other stakeholders.

In the UK and around the world, leading investors are already requisitioning resolutions at company
Annual General Meetings (AGMs) to include a non-binding advisory ‘say on climate’ vote at each
subsequent AGM.12 These resolutions are a clear indicator of the high priority which investors are
placing on this concept and of the materiality of the information which they are requesting. While investor
action has been important in driving this initiative, requisitioning resolutions at every company is highly
inefficient and costly.

In order to level the playing field for all companies and reduce costs for investors, non-binding advisory
‘say on climate’ votes should be required by law for all listed companies and large private companies.
This will help provide an additional and important market-led accountability mechanism for investors to
publicly signal their approval or disapproval with a company’s climate change-related disclosures and
emission reduction strategy. Notably, this approach has already been advocated for strongly by the UK
Investor Forum, which represents members with over £20 trillion assets under management.13

5. Provide financial regulators with effective enforcement powers

In ClientEarth’s view, the biggest barrier to better climate change-related reporting in the UK is the
current enforcement and accountability gap.14 In recent years, ClientEarth has made numerous
complaints to the FCA and FRC regarding companies’ failures to adequately disclose material climate-

10 See CCLI, ‘Concerns misplaced: Will compliance with the TCFD expose directors to liability risk?’ (2017).
11 See further, CIFF, ‘Say on Climate: Shareholder Voting on Climate Transition Action Plans’.
12 See, eg, Reuters, ‘Show us the plan: Investors push companies to come clean on climate’ (2021)
13 Investor Forum, ‘Say on Climate: An opportunity to deliver impact in the UK’ (2020)
14 See further, ClientEarth, ‘Accountability Emergency, A review of UK-listed companies’ climate change-related
reporting (2019-20)
related information under existing disclosure laws. In all cases, the reported companies were in high-risk sectors but disclosed no meaningful information about climate change-related risks in their annual reports. Despite this evidence, the FRC and the FCA took no public enforcement action. We believe that failures by the FRC and FCA to enforce the law severely undermines investor demands for market-wide, decision useful climate change-related information and that their existing powers and resources are insufficient.

The consultation briefly notes some of the existing general accountability and enforcement mechanisms (Questions 12 and 13). In our experience, these are highly inadequate. Currently, the FRC has no meaningful powers to hold companies or their directors directly accountable for failures to disclose material information to shareholders, be that related to climate change, or otherwise. The power of the Secretary of State and/or the FRC to apply to the court for an order requiring the preparation of revised accounts and/or reports is weak, costly and procedurally difficult. To the best of our knowledge, it has never been used. We note that BEIS is currently consulting on replacing the FRC with a new Audit, Reporting and Governance Authority (ARGA) which it is proposed would have a new power to direct changes to company reports and accounts without obtaining a court order. While the FCA has somewhat more effective enforcement powers at its disposal, so far, it has been very reluctant to use them, and they only apply to listed companies.

The UK’s weak enforcement framework has been criticised directly by the European Securities and Markets Authority (ESMA) in its Peer Review Report on Enforcement of Financial Information. The lack of powers and resources is also highly anomalous compared to other jurisdictions. Corporate reporting regulators in the US, Australia, Canada and across Europe all have direct powers to require reporting restatements and hold companies and directors accountable for breaches. In order to ensure that companies and their directors are appropriately incentivised to provide fair, balanced and material climate change-related information to investors and other stakeholders, and to minimise increasing risks of ‘greenwashing’, the FRC (or ARGA) and FCA must be provided with powers to require restatements and hold companies and their directors to account for providing inadequate or misleading disclosures, and given adequate resources to do so.

6. Require auditors to provide assurance for these disclosures

In ClientEarth’s recent review of reporting by the 250 largest listed UK companies, we found that just 4% of audit reports clearly referred to whether or not the auditors had considered climate change-related factors in conducting their audit. In light of clear demands from investors for companies to align their accounts with the Paris Agreement goals and for auditors to take this into account in their audits, this is a serious shortcoming that must be rectified.

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15 See, eg, ClientEarth, ‘Insurance firms could face fines over climate reporting failure’ (2018).
17 ESMA, "Peer Review on guidelines on Enforcement of Financial Information" (2017) [74]
18 See, in particular, new penalties and enforcement powers for EU regulators proposed in European Commission, ‘Text of the proposal for a Corporate Sustainability Reporting Directive’ (2021)

Classification: Internal
The consultation document notes the role of auditors in providing assurance in relation to company financial statements and the opinions that they are required to provide regarding ‘other information’ included within the annual report. It also notes that it is not intending to alter the role of auditors in relation to climate-related financial disclosures. Given clear failings by auditors under current requirements, this would be a mistake. In order to provide investors and other stakeholders with confidence they need in climate change-related disclosures, auditors must ultimately be required to provide an integrated audit over the entire annual report, including any new disclosure requirements arising as a result of this consultation. As an interim step, at the very least, auditors must be required to provide ‘a limited assurance’ opinion in relation climate-related disclosures included in the Strategic Report,21 and to specifically test accounts against Paris-aligned assumptions and estimates and flag to shareholders where the assumptions fall short.22

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21 As proposed at the EU level, see: European Commission, ‘Text of the proposal for a Corporate Sustainability Reporting Directive’ (2021).
22 As proposed by leading investors, see: IIGCC, ‘Investor Expectations for Paris-aligned Accounts’ (2020).