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Legal, Convergence and Enforcement Department
European Securities and Markets Authority (ESMA)
CS 60747
103 rue de Grenelle
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21 January 2016

Dear Ms Vuarlot-Dignac

**Climate risk disclosures by companies in the oil and gas, and coal sectors**

1. ClientEarth,[1] Climate Disclosure Standards Board,[2] CDP Europe[3] and ShareAction[4] are submitting this letter to ESMA on reporting obligations which require climate risk disclosures by companies in the oil and gas, and coal sectors (referred to as **fossil fuel companies**).

2. The value of disclosure to ensuring effective and well-functioning capital markets is clear. Climate change and related legal, policy and technology responses present material risks for fossil fuel companies (referred to as **climate risk**). It is vital that fossil fuel companies disclose their climate risk so that investors can make informed decisions about, and engage in effective stewardship with, the companies they invest in.

3. To support ESMA's mission to enhance investor protection and promote stable and orderly financial markets, we encourage ESMA to act to:

    - ensure climate risk disclosures are included in management reports from fossil fuel companies. Reporting of climate risk is an emerging practice and is a trend, risk or vulnerability which is relevant to ESMA's activities on assessing risks to investors, markets and financial stability; and

    - promote supervisory convergence on climate risk disclosures by fossil fuel companies, through ensuring a consistent regulatory approach by competent authorities.

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[1] ClientEarth (registered on the European Transparency Register with ID Number 96645517357-19) is a leading environmental law NGO with offices in London, Brussels and Warsaw. We are lawyers who use the law as a tool for tackling key environmental challenges such as climate change. http://www.clientearth.org/

[2] Climate Disclosure Standards Board is an international consortium of business and environmental NGOs committed to advancing and aligning the global mainstream corporate reporting model to equate climate change-related and environmental information with financial capital by offering companies a framework for reporting these with the same rigour. www.cdsb.net

[3] CDP Europe is a Berlin based charity, which is part of the CDP worldwide network. CDP is an international NGO that provides the only global environmental disclosure platform for companies to report climate change and greenhouse gas emissions information to investors and other stakeholders. CDP acts on behalf of 822 institutional investors with assets of US$95 trillion. www.cdp.net

[4] ShareAction is a charity that promotes Responsible Investment and gives savers a voice in the investment system. ShareAction is recognised as the leading NGO that monitors and engages with the investment industry. www.shareaction.org/

## Climate risk is material for fossil fuel companies

*Climate legislation and policy*

4. The Paris Agreement[5] is a universal, legally binding climate agreement. It commits all 195 member nations to a goal of keeping the increase in global average temperature to well below 2ºC above pre-industrial levels (and an aim of keeping the increase to 1.5ºC above pre-industrial levels).[6]

5. To meet this goal, all nations agreed to reach global peaking of greenhouse gas emissions as soon as possible, and to undertake rapid reductions thereafter in accordance with best available science to achieve net zero emissions post 2050.[7] Each nation will publish its *nationally determined contribution* to the goal of the Paris Agreement, and pursue mitigation measures to achieve the objectives of its contribution.[8]

6. All nations agreed to an enhanced transparency framework for building mutual trust and confidence, and promoting effective implementation of the Paris Agreement.[9] Each nation shall provide information necessary to track progress implementing and achieving its nationally determined contribution.[10] This information also informs the *global stocktake* - a periodic assessment of global progress towards the goal of the Paris Agreement.[11]

*The Paris Agreement necessitates a carbon budget*

7. The goal of the Paris Agreement severely impacts on fossil fuel companies - because fossil fuel combustion is the primary source of anthropogenic greenhouse gas emissions.

8. A 2011 report concluded that, to have an 80% chance of limiting warming to 2ºC, 80% of existing fossil fuel reserves must remain unused.[12] This conclusion is consistent with analysis from the International Energy Agency and the Intergovernmental Panel on Climate Change.[13] A more recent study concluded that, to have a mere 50% chance of limiting warming to 2ºC, one third of oil reserves, half of gas reserves, and over 80% of coal reserves should remain unused.[14]

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[5] Signed at the UN sponsored 21st Conference of the Parties in Paris during December 2015 and available at: https://unfccc.int/resource/docs/2015/cop21/eng/l09r01.pdf
[6] Article 2, Paragraph 1(a), Paris Agreement.
[7] Article 4, Paragraph 1, Paris Agreement.
[8] Article 4, Paragraph 2, Paris Agreement.
[9] Article 13, Paragraph 1, Paris Agreement.
[10] Article 13, Paragraph 7(b), Paris Agreement.
[11] Article 14, Paragraph 1, Paris Agreement.
[12] Carbon Tracker, 2011. *Unburnable Carbon - Are the world's financial markets carrying a carbon bubble?* [Online] Available at: http://www.carbontracker.org/wp-content/uploads/2014/09/Unburnable-Carbon-Full-rev2-1.pdf [Accessed 22 December 2015], p.6. Carbon Tracker's carbon budget was grounded in peer-reviewed scientific literature on emissions and warming pathways. See Meinhausen et al., 2009. "Greenhouse-gas emission targets for limiting global warming to 2°C" *Nature,* 458, 1158-1162.
[13] A comparison of the IEA, IPCC and Carbon Tracker carbon budgets is available at: http://carbontracker.org/wp-content/uploads/2014/08/Carbon-budget-checklist-FINAL-1.pdf.
[14] McGlade, C., Ekins, P., 2015. "The geographical distribution of fossil fuels unused when limiting global warming to 2ºC" *Nature*, 517, 187-190.

*The carbon budget is financially material for fossil fuel companies*

9. The goal of the Paris Agreement restricts society to burning one fifth to one third of existing fossil fuel reserves. This will drastically reduce demand for fossil fuel commodities. In addition, HSBC research indicates reduced demand caused by these international efforts will lead to lower commodity prices.[15]

10. This will impact fossil fuel companies' cash flows and margins and jeopardise returns on high cost projects. This means the highest cost projects will be uneconomic and many existing fossil fuel reserves would become "stranded". Business as usual is no longer possible - fossil fuel companies must adapt or fail.

11. Climate risk is therefore material for fossil fuel companies – and may even constitute an existential threat. Indeed the total value at risk for some companies could potentially be equivalent to 40-60% of company market capitalisation in a 2ºC scenario.[16]

**Relevant legal reporting requirements**

12. The Transparency Directive[17] requires public companies[18] to publish a management report each year.[19] Further requirements for the management report are set out in the Accounting Directive[20] (as amended by the Non-Financial Reporting Directive[21]).

13. This letter addresses two components of the management report that require climate risk disclosures by fossil fuel companies:

    - the description of principal risks and uncertainties and indication of likely future development; and
    - the information on environmental matters included in the non-financial statement (required for larger public companies).

*Principal risks and uncertainties and likely future development*

14. For all public companies[22], the management report shall include a fair review of the development and performance of the business as well as a description of the principal risks and uncertainties that it faces.[23]

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[15] Spedding et al., 2013. *Oil and carbon revisited: Value at risk from 'unburnable' reserves*.
[16] Spedding et al., 2013. *Oil and carbon revisited: Value at risk from 'unburnable' reserves*.
[17] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC.
[18] Specifically it refers to issuers which are defined as 'a natural person, or a legal entity governed by private or public law, including a State, whose securities are admitted to trading on a regulated market' (Article 2, Paragraph 1(d), Transparency Directive).
[19] This should be included in the annual financial report together with audited financial statements and statements from responsible persons (Article 4, Paragraphs 1 and 2, Transparency Directive).
[20] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC.
[21] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

15. This information should be consistent with the size and complexity of the business - for large or complex companies the information must be correspondingly more detailed. If necessary to understand the company's development, performance or position, this information shall include financial and (where appropriate) non-financial key performance indicators, including information relating to environmental or employee matters.[24] Therefore environmental matters related to the business *must* be disclosed, if this is necessary for an understanding of the company's development, performance or position.

16. The management report must also give an indication of the company's likely future development.[25] The information required to satisfy this requirement therefore has a forward looking lens.

17. Climate risk is clearly a principal risk or uncertainty facing every fossil fuel company, and will clearly impact on the likely future development. Climate change is a material environmental matter for fossil fuel companies. Therefore information on climate risk is crucial for an understanding of every fossil fuel company's development, performance and position. Consequently climate risk (and critically the stranded asset risk) must be disclosed in every fossil fuel company's management report to satisfy these disclosure requirements.

*Non-financial statement*

18. Climate risk is a material financial issue for fossil fuel companies which should be disclosed to satisfy the requirements set out above. However the non-financial statement is also relevant to the reporting of elements of climate risk.

19. For large public companies[26] the management report shall also include a non-financial statement. This contains information on environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters – if required for understanding the company's development, performance, position and impact of its activity.[27]

20. The non-financial statement should include a description of the company's policies in relation to these matters (as well as the outcomes of those policies). It should also include the principal risks related to these matters (linked to the company's operations) and how these risks are managed. Non-financial key performance indicators should also be included in the non-financial statement (and this shall satisfy the disclosure requirements for non-financial information set out in paragraph 15 above).[28]

21. According to these criteria, information on climate risk and the company's response must be included in the non-financial statement of every fossil fuel company. Climate change

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[22] Although note that Member States may exempt small undertakings for these disclosure obligations (Article 19, Paragraph 3, Accounting Directive).
[23] Article 19, Paragraph 1, Accounting Directive.
[24] Article 19, Paragraph 1, Accounting Directive.
[25] Article 19, Paragraph 2, Accounting Directive.
[26] Specifically '[l]arge undertakings which are public-interest entities exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year' (Article 19a, Paragraph 1, Accounting Directive).
[27] Article 19a, Paragraph 1, Accounting Directive.
[28] Article 19a, Paragraphs 1 and 2, Accounting Directive.

is a material environmental matter, as well as a social and human rights matter, which is necessary for an understanding of every fossil fuel company's development, performance, position. Further climate change is a direct impact of every fossil fuel company's activity.

**ESMA's activities to achieve its mission**

22. ESMA's actions relating to the Transparency Directive are intended to foster common procedures and consistent application throughout the EU by building a common supervisory culture among competent authorities.

23. Increasing regulatory scrutiny of climate risk disclosures is evident from numerous sources. In the UK, the Financial Reporting Council has written to Audit Committee Chairman of larger listed companies ahead of the 2016 reporting season to communicate investor expectations on climate risk disclosures.[29]

24. In the US, the New York Attorney General has recently concluded an investigation into Peabody Energy Corporation's climate disclosures. Although Peabody publically denied its ability to predict the impact of future climate legislation or policy, the Attorney General found the company could in fact predict severe impacts which could materially and adversely affect its business and financial condition. Peabody must now provide additional disclosures in its annual reporting. The Attorney General is now conducting an investigation into misleading statements in relation to climate change provided by Exxon.

25. The Financial Stability Board has also announced it is establishing a Task Force on Climate-related Financial Disclosures. This will develop consistent climate related financial risk disclosures for companies providing information to lenders, insurers, investors and other stakeholders.[30] In the US, the Securities and Exchange Commission has already published guidance regarding disclosures related to climate change.[31]

26. To support ESMA's mission, we encourage ESMA to align with the work of the Task Force on Climate-related Financial Disclosures, and act to assist competent authorities ensure climate risk disclosures (particularly those related to stranded asset risk) are included in management reports from fossil fuel companies. In addition, we encourage ESMA to act to ensure a consistent regulatory approach by competent authorities for climate risk disclosures by fossil fuel companies.

27. We would welcome the opportunity to engage in additional dialogue with ESMA. We also offer our assistance to ESMA in developing an appropriate strategy to achieve its mission in relation to the points raised in this letter.

Yours sincerely

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[29] Financial Reporting Council, 2015. *Summary of key developments for 2015 annual reports*. [Online] Available at: https://frc.org.uk/Our-Work/Publications/FRC-Board/Year-end-advice-to-preparers-larger-listed-compa.pdf [Accessed 29 December 2015].
[30] Perry, J., 2015. *FSB to establish Task Force on Climate-related Financial Disclosures* [Online] Available at: http://www.fsb.org/2015/12/fsb-to-establish-task-force-on-climate-related-financial-disclosures/ [Accessed 21 December 2015].
[31] SEC, 2010. *Commission Guidance Regarding Disclosure Related to Climate Change* [Online] Available at: https://www.sec.gov/rules/interp/2010/33-9106.pdf [Accessed 21 December 2015].

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