ClientEarth

August 2021

FCA Consultations CP21/17 and CP21/18 on enhancing climate-related disclosures

ClientEarth briefing

Top Lines

- ClientEarth welcomes the FCA's consultations on expanding climate-related disclosure requirements to (i) asset managers, life insurers and FCA-regulated pension providers (consultation "**CP21/17**") and (ii) issuers of standard listed equity shares, and to invite views on environmental, social, and governance ("**ESG**") topics in capital markets (consultation "**CP21/18**"). However, the disclosure requirements and scope of companies proposed are insufficient to ensure the granularity of detail investors and other stakeholders need and are entitled to expect to make informed decisions on capital investment and/or reallocation.

- Our analysis of annual reporting published in 2021 suggests that companies are discussing climate change and environmental impacts, risks, and opportunities more than in the past. However, there is a pervasive lack of clarity on what action on climate change companies are actually taking, and/or are committed to taking at, or by, some future date. Companies are increasingly providing information that is unclear, incomplete, and potentially misleading. Such reports may give rise to greenwash, in that statements made may lead investors and other stakeholders to believe businesses are doing more to combat climate change than is really the case. It follows that where information of this nature is incomplete or misleading, consumers and investors are put at risk, and may even be prevented from directing capital in line with net zero or other sustainable transition commitments.

- Further, it is clear from the IPCC's recent sixth assessment report (the "**2021 IPCC Report**") that we must, globally, achieve rapid emissions reductions and transition to net-zero emissions by 2050, in line with the IPCC's very low emissions scenario,[1] to limit warming to 1.5°C by the end of the century. Mandatory, transparent climate-related disclosures are a necessary first step to achieving this transition by (i) facilitating the timely reallocation of capital away from carbon-intensive business, and (ii) ensuring accountability in relation to harnessing (or failing to manage) climate change, including its associated risks, impacts and opportunities.

- This briefing sets out ClientEarth's position and recommendations on improving climate-related reporting in response to CP21/17 and CP21/18. We believe that our recommendations, if adopted, will:
    - facilitate the timely disclosure of more granular and company-specific information about climate change-related risks, impacts and opportunities for investors and other stakeholders, which is material to their investment and stewardship decision-making[2];
    - ensure that financial accounts reflect these matters and are aligned with the goals of the Paris Agreement and the UK's commitment to achieve net zero emissions by 2050, in line with investor expectations[3]; and
    - better enable the FCA to (i) meet its statutory objectives to make markets function well, protect consumers, enhance the integrity of the financial system and promote competition[4], and (ii) meet its remit from HM Treasury to take into account the UK's net-zero target.[5].

- We welcome discussion on these matters and strongly encourage other stakeholders to consider and adapt these points in preparing their own responses to the consultations (**deadline to respond: 10 September 2021**).

Recommendations relevant to both consultations

1. Transition plans: While we support the FCA's proposals to require in-scope firms to disclose transition plans, these must be aligned with the best available science, and **at a minimum** with the UK Government's commitment to achieve net-zero emissions by 2050, including reducing emissions by 68% and 78% (compared to 1990 levels) by 2030 and 2035 respectively[6], and

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[1] See Scenario SSP1-1 of the sixth assessment report from the Intergovernmental Panel on Climate Change, 'Climate Change 2021: The Physical Science Basis' (9 August 2021)
[2] See, for example, Climate Action 100+'s 2020 Progress Report on investor-engaged focus companies' growing net zero commitments, related IIGCC press release, and most recently the Climate Action 100+ Net–Zero Company Benchmark
[3] Investor Expectations for Paris-aligned Accounts (November 2020, IIGCC)
[4] Section 1B(2), Financial Services and Markets Act 2000 (as amended)
[5] Letter from the Chancellor of the Exchequer to the Chief Executive of the Financial Conduct Authority (FCA) providing recommendations for the FCA (24 March 2021). This is also reflected in the Financial Services Act 2021 and the new section 143G Financial Services and Markets Act 2000 (FSMA) (coming into force from 1 January 2022).
[6] The Government's 'UK Nationally Determined Contribution' (2020) commits to reduce emissions by 68% (compared to 1990 levels) by 2030, and the Carbon Budget Order 2021 implies a 78% reduction in emissions (compared to 1990 levels) by 2035.

include short term (2 to 5 year) and medium term (6 to 15 year) interim targets. A mandate that firms specifically target net-zero emissions[7] would:

(i) help mitigate transition risk (including the burden of responding to further regulatory and legal step changes to achieve the IPCC's very low emissions scenario, which we consider is inevitable in circumstances where the UK Government's roadmap for climate related disclosures[8] is currently out of step with that scenario); and

(ii) be consistent with investor demands as to the materiality[9] of information on companies' strategic alignment with the goals of the Paris Agreement[10].

2. Accounts: The FCA should require all in-scope firms to Paris-align their financial accounts and **at a minimum** align them with the UK's emissions reduction targets, and expressly confirm that accounts take account of transition plans disclosed. If accounts cannot be so aligned, firms should disclose what adjustments would be required for them to be so[11]. Proper testing against Paris-aligned assumptions and estimates will reduce the risk of inaccurate cost and return information (for example, failing to reflect asset impairments) and of misleading investors. Further, it will better enable companies to set and adhere to credible transition plans, in line with investor expectations.

3. Scope 3 emissions: Now that data and methodologies have matured sufficiently[12], the FCA must expressly require that all in-scope firms, across all sectors, disclose all categories of scope 3 emissions for which they are responsible. This will facilitate better decision-making by all stakeholders, including firm strategy and adaptation measures. We also consider this recommendation critical to facilitating the low carbon economy transition because:

(i) scope 3 emissions are the largest source of a company's emissions in most sectors[13], meaning disclosure of scopes 1 and 2 only presents a dangerously incomplete picture of emissions reduction progress; and

[7] For example, the Advisory Group on Finance for the UK's Climate Change Committee recommended in 'The road to Net-Zero Finance' (2020) that the UK must mandate that financial institutions make net-zero plans, rather than solely seek to mitigate financial risks.
[8] A Roadmap towards mandatory climate-related disclosures (2020).
[9] For example, see 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).
[10] For example, 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'. Climate Action 100+, 'Net-Zero Company Benchmark' (2020).
[11] This is consistent with our recent response to the BEIS consultation on restoring trust in audit and corporate governance (8 July 2021)
[12] See the TCFD's recent consultation documents, '*Proposed Guidance on Climate-related Metrics, Targets, and Transition Plans*' and the associated '*Measuring Portfolio Alignment: Technical Supplement*' (FSB-TCFD, July 2021)
[13] Science Based Target Initiative, 'Value Change in the Value Chain: Best Practices in Scope 3 Greenhouse Gas Management' (2018). It is estimated that the scope 3 emissions of oil and gas companies are six times their scope 1 and 2 emissions (see MSCI, 'Scope 3 Carbon Emissions: Seeing the Full Picture' (2020)) and that the portfolio emissions of global financial institutions are over 700 times greater than their operational emissions (see CDP, 'Financial Services Disclosure Report 2020: The Time to Green Finance' (2020).).

(ii) the current voluntary framework is not fit for purpose, in that our analysis has found the majority of firms opt out[14].

4. Enforcement: The FCA must close the accountability gap on climate-related reporting, because it is currently failing to ensure the requisite degree of accountability that investors and other stakeholders need and are entitled to expect[15]. Specifically, it must procure that it is adequately empowered and resourced to hold laggards accountable for failures to satisfy climate change-related reporting obligations – both those existing and to be implemented – via robust, consistent, and timely enforcement action. This will enable the FCA to fulfil its new remit on climate change (to have regard to the Government's commitment to achieve a net-zero economy by 2050 when considering how to advance its objectives and discharge its functions[16]). If the FCA does not secure compliance, it risks being ignored by those it regulates; its inaction to date already poses a direct threat to market function, consumer protection, and the integrity of the UK's financial markets.

Recommendations specific to CP 21/17

5. Scope: The scope of companies to which the new rules should apply must be expanded: (i) the new 'entity-level' disclosures should be a requirement for **all** FCA regulated firms of all sizes; not just asset managers, life insurers and FCA-regulated pension providers with assets under management of £5 billion or over, (ii) the new core metrics in the 'product-level' disclosures should apply to asset managers, life insurers and FCA regulated pension providers of all sizes (i.e. removing the £5 billion or over assets under management threshold), and (iii) the additional metrics in the product-level disclosures should be mandatory for asset managers, life insurers and FCA regulated pension providers with assets under management of £5 billion or over (rather than being on a best efforts basis, as currently proposed).

   These recommendations are:

   (i) consistent with recent recommendations by the Advisory Group on Finance for the UK's Climate Change Committee that all financial institutions must make net-zero transition plans;

   (ii) would positively enhance the PRA's expectations that banks and insurers disclose and manage climate-related risks (which are not binding and, in our view, do not go far enough)[17]; and

   (iii) proportionate (including as to costs[18]), in that the TCFD recommendations (which the FCA proposes to incorporate) allow companies to disclose according to their size and

[14] Two thirds of FTSE 250 companies in 2019-2020 did not disclose their scope 3 emissions, and those that did were often not fully transparent about the methodology and exclusions applied in calculations – see our 'Accountability Emergency, A review of UK-listed companies' climate change-related reporting (2019-20)' (4 February 2021).
[15] See ClientEarth's recent letter to the FCA, 'Climate change and corporate reporting: the role of the FCA' (18 August 2021)
[16] Letter from the Chancellor of the Exchequer to the Chief Executive of the Financial Conduct Authority (FCA) providing recommendations for the FCA (24 March 2021). This is also reflected in the Financial Services Act 2021 and the new section 143G Financial Services and Markets Act 2000 (FSMA) (coming into force from 1 January 2022).
[17] SS3/19
[18] The FCA has acknowledged that for its own proposals, "*the estimated costs of compliance are small relative to total assets under management of in-scope asset managers and asset owners. Total one-off and ongoing costs*

circumstance. Finally, data and methodologies for the preparation of climate-related disclosures, while not perfect, have now advanced significantly, and can be further refined through common use[19].

6. Timing: In view of the urgency with which action to reduce emissions is required (per the 2021 IPCC Report) the FCA's new rules should be introduced for all in-scope companies for periods beginning January 2022 (instead of the FCA's current proposal to extend to some companies only from January 2023). While ambitious, we consider this timeframe is realistic and proportionate given advancements in data and methodologies, which can be further refined through common use. Uncertainty is not a reasonable excuse to delay implementation.

Recommendations specific to CP21/18

7. Mandatory basis: The rules should be introduced on a clear mandatory basis, not a weak and confusing 'comply or explain' approach[20]. Anything less risks depriving investors and other stakeholders of the 'decision useful' information they need now and are entitled to expect. This recommendation, if adopted, would better enable the redirection of capital urgently required to achieve the IPCC's very low emissions scenario. As such, any additional liability risk is proportionate, and would be limited in any event because existing laws protect companies and directors from frivolous or unfounded litigation in respect of good faith climate-related disclosures[21].

8. Audit of annual report: Auditors must at least be required to provide a 'limited assurance' opinion in relation climate-related disclosures included in the annual report. Consideration of material climate change-related trends and risks facing a company, including whether such trends and risks might have implications for assumptions and estimates used in preparing financial accounts themselves[22], provides investors with greater confidence the information can be trusted. This serves a critical role in providing investors with assurance (to the standard set by relevant ISAs) that information disclosed by companies about trends and risks facing their business has been prepared in accordance with the relevant legal requirements, is free from material misstatements, and is otherwise fair, balanced and understandable.

9. Listed debt: Issuers of standard listed debt (and debt-like) securities should be included within scope of the rules. This is because investors in listed debt are no less entitled to receive detailed and comprehensive climate related information. This recommendation, if adopted, would allow those investors to better assess the resilience of relevant issuers to climate change, along with the environmental impacts issuers are either exposed to or responsible for.

10. GDRs and non-equity shares: As for listed debt issuers, the new disclosure rules should apply to standard listed issuers of global depositary receipts (bank-issued certificates which represent

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represent 0.002% and 0.001% of total assets under management for asset managers and asset owners, respectively" – see paragraph 2.7 of Annex 2 ('Costs benefit analysis') at page 50, CP21/17 (FCA, 22 July 2021)

[19] 'Uncertainty Is Not an Excuse. Integrating Climate Risks into Monetary Policy Operations and Financial Supervision' (SUERF Policy Briefs No 72, April 2021)

[20] See ClientEarth's 'FCA climate risk disclosure consultation briefing' on LR9.8.6(8) – in particular paragraph 1 (7 August 2020)

[21] See CCLI, 'Concerns misplaced: Will compliance with the TCFD expose directors to liability risk?' (2017).

[22] This position is consistent with our recent response to the BEIS consultation on restoring trust in audit and corporate governance (8 July 2021)

shares in the issuer, conveying a similar interest to equity share ownership) and standard listed issuers of shares other than equity shares. This recommendation, if adopted, would allow those investors to better assess the resilience of relevant issuers to climate change, along with the environmental impacts issuers are either exposed to or responsible for.

11. Overlap with BEIS disclosures: Companies that fall within scope of the FCA's climate-related disclosure proposals under CP21/18 and the BEIS climate-related disclosure regime for quoted and large companies[23] should be required to make a single disclosure in the strategic report fulfilling both sets of rules. This would be clearer, more straightforward and more readily comprehensible for investors than providing separate differing disclosures in multiple locations in the annual report. In our view, coordinating regimes in this way would reduce the already significant burden on investors to review and identify material disclosures, and better facilitate timely decision making on capital (re)allocation.

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[23] See the BEIS Consultation on requiring mandatory climate-related financial disclosures by publicly quoted companies, large private companies and Limited Liability Partnerships (LLPs) (2021)