Financial Regulatory Alert

Akin Gump
STRAUSS HAUER & FELD LLP

UK Proposes New Climate-related Disclosure Rules for Standard Listed Companies

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In November 2020, the UK government published "Roadmap"[1] setting out its aims for mandatory climate-related disclosures across the UK economy, in a manner aligned with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD).

Climate-related disclosures are not entirely new in the United Kingdom, and premium listed companies will be required to include TCFD-aligned disclosures in their annual financial reports for 2021 on an enhanced comply or explain basis (as described below). As part of the Roadmap's aim for these disclosures to permeate the economy more fully, however, the UK Financial Conduct Authority (FCA) has now published a Consultation Paper proposing to extend this regime to all issuers of standard listed equity shares (except for standard listed investment entities and shell companies). This Consultation Paper, CP 21/18,[2] is open for comment until 10 September 2021.

At the same time as issuing this Consultation Paper, the FCA issued a separate paper proposing a new climate-related disclosure regime for asset managers and asset owners. Our article on this Consultation Paper, CP21/17, can be found here.

Scope

The FCA's current proposal is that the regime currently applicable to companies with a premium listing should be extended to all issuers of standard listed equity shares (save for investment entities[3] and shell companies[4]). The FCA has noted that around half of the companies which are expected to be brought into scope by the expansion are in the "basic resources, financial services and energy sectors", and that these are sectors "where there is considerable investor interest in companies' climate strategies, including transition plans".[5]

In the consultation, however, the FCA is also specifically seeking views on whether the regime should also be extended to companies with a standard listing of debt and debt-like securities, global depository receipts and securitised derivatives.

Enhanced "Comply or Explain" Basis

The FCA's proposal is that the disclosure requirement should be a direct extension of the rules applicable to premium listed companies to standard listed companies.

Unlike the proposed rules for asset managers and asset owners, this means that the FCA is proposing to permit companies to comply with these disclosure requirements

Contact Information

If you have any questions concerning this alert, please contact:

Ezra Zahabi
Partner
ezra.zahabi@akingump.com
London
+44 20.7661.5367

Helen Marshall
Partner
helen.marshall@akingump.com
London
+44 20.7661.5378

Weyinmi Popo
Partner
weyinmi.popo@akingump.com
London
+44 20.7012.9847

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on an enhanced “comply or explain” basis. Under this enhanced comply or explain regime, the FCA expects that companies will ordinarily comply with the disclosure rules, “except where [a company] faces transitional challenges in obtaining relevant data or embedding relevant modelling or analytical analysis”.[6] As discussed below in more detail, the FCA has gone so far as to indicate the particular disclosure rules with which it expects companies may currently have transitional challenges in complying. It should be reiterated, however, that the FCA does view this enhanced “comply or explain” regime as a temporary measure, and ultimately the FCA “strongly support[s] a pathway to mandatory climate-related disclosures”.[7]

The temporary nature of the enhanced “comply or explain” regime is also evident in the explanations required of a company which decides not to comply with a particular disclosure rule: the company must provide a list of the recommendations and/or recommended disclosures for which it has not included disclosures, an explanation of why it has not included such disclosures, and a description of any steps the company is taking or plans to take to be able to make consistent disclosures in the future, and the time frame within which it expects to be able to make those disclosures.[8]

Disclosure Requirements

Assuming the draft rules are made final, this means, then, that in-scope standard listed companies will have to include a statement in their annual financial report setting out:

- Whether the company has made disclosures consistent with the TCFD Recommendations and Recommended Disclosures (see below) in its annual financial report.[9]
- Where the company has made disclosures consistent with the TCFD Recommendations and Recommended Disclosures, but has included some or all of these disclosures in a document other than the annual financial report, a list of the recommendations and/or recommended disclosures for which it has included disclosures in that other document, a description of the other document and where it can be found, and the reasons for including the relevant disclosures in that document and not in the annual financial report.[10]
- As stated above, where the company has not made disclosures consistent with some or all of the TCFD’s recommendations and/or recommended disclosures, a list of the recommendations and/or recommended disclosures for which it has not included disclosures, an explanation of why it has not included such disclosures, and a description of any steps the company is taking or plans to take to be able to make consistent disclosures in the future, and the time frame within which it expects to be able to make those disclosures.[11]
- Where the climate-related financial disclosures can be found, whether in the annual financial report or another document.[12]

TCFD Recommendations and Recommended Disclosures

The TCFD Recommendations and Disclosures referred to above can be found on page 22 of the TCFD’s Final Report (here), and constitute four “recommendations” and 11 “recommended disclosures”, namely:

1. **Governance**: disclose the organisation’s governance around climate-related risks and opportunities. The recommended disclosures are:
    a. Describe the board’s oversight of climate-related risks and opportunities.
    b. Describe management’s role in assessing and managing climate-related risks and opportunities.

2. **Strategy**: disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning where such information is available. The recommended disclosures are:
    a. Describe the climate-related risks and opportunities the organisation has identified over the short, medium and long term.
    b. Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning.
    c. Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.
3. **Risk management**: disclose how the organisation identifies, assesses and manages climate-related risks. The recommended disclosures are:
    a. Describe the organisation's process for identifying and assessing climate-related risks.
    b. Describe the organisation's processes for managing climate-related risks.
    c. Describe how processes for identifying, assessing and managing climate-related risks are integrated into the organisation's overall risk management.
4. **Metrics and targets**: disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material. The recommended disclosures are:
    a. close the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process.
    b. Disclose Scope 1, Scope 2 and, if appropriate, Scope 3 greenhouse gas emissions, and the related risks.
    c. Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.

As noted above, the FCA only expects companies to explain noncompliance with a particular disclosure rule "where [the company] faces transitional challenges in obtaining relevant data or embedding relevant modelling or analytical capabilities".[13] The FCA has given guidance that it expects companies "ordinarily" to be able to make all the recommended disclosures relating to governance and risk management (as listed above), and recommended disclosures (A) and (B) relating to strategy (as listed above). In saying this, the FCA appears to be indicating that it expects that companies are most likely to have transitional difficulties in complying with strategy recommended disclosure (C) and the metrics and targets recommended disclosures.

It is worth reiterating, however, that the FCA remains clear that any such difficulties should only be thought of as temporary and transitional, and firms not complying will have to provide description of any steps the company is taking or plans to take to be able to make consistent disclosures in the future, and the time frame within which it expects to be able to make those disclosures.[14]

Determining Consistency with the TCFD Recommendations and Recommended Disclosures

In determining whether the disclosures made in the annual financial report are "consistent" with the TCFD Recommendations and Recommended Disclosures, the company should make a detailed assessment of those disclosures, and they should consider whether the disclosures provide sufficient detail to enable users to assess the company's exposure and approach to addressing climate-related issues, given (i) the level of its exposure to climate-related risks and opportunities, (ii) the scope and objectives of its climate-related strategy and (iii) the nature, size and complexity of the company's business.[15]

Further the company should consider the related guidance from the TCFD, including:[16]

- The TCFD Annex entitled "Implementing the Recommendations of the TCFD" (available here).
- The TCFD Technical Supplement on the Use of Scenario Analysis (available here).
- The TCFD Guidance on Risk Management Integration and Disclosures (available here).
- (Where relevant) the TCFD Guidance on Scenario Analysis for Non-Financial Companies (available here).
- If and when it is published in final form by the TCFD, the TCFD Guidance on Metrics, Targets and Transition Plans (draft available here).
- The TCFD Technical Supplement on Measuring Portfolio Alignment (available here).

[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/933783/FINAL_TCFD_ROADMAP.pdf.

[2] https://www.fca.org.uk/publication/consultation/cp21-18.pdf.

[3] Particularly with respect to investment entities, the FCA expects that "some of these will fall within the scope of [the] proposed TCFD-aligned rules for asset managers", as discussed in our article here.

[4] The FCA notes at para 3.8 of the Consultation Paper that the "form and structure of the TCFD's recommendations would not seem to be appropriate considering such companies' simple balance sheets and that they typically do not have established governance, strategy and risk management arrangements".

[5] Consultation Paper, para 3.11.

[6] Listing Rules (LR) 14.3.31 G. Compare with LR 9.8.6E G (1).

[7] CP para 3.50.

[8] LR 14.3.27 R (2)(b).

[9] LR 14.3.17 R (1).

[10] LR 14.3.27 R (2)(a).

[11] LR 14.3.27 R (2)(b).

[12] LR 14.3.27 R (3).

[13] LR 14.3.31 G.

[14] LR 14.3.27 R (2)(b).

[15] LR 14.3.30 G.

[16] LR 14.3.29 R.

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