

FCA Consultation on Climate-Related Disclosures by Listed Companies

26 March 2020

On 6 March 2020, the UK Financial Conduct Authority (“FCA”) published a consultation paper (CP 20/3) which contained a number of proposals with regard to disclosures by listed companies in respect of climate-related risks and opportunities that affect, or may affect, their businesses.

The impetus for the FCA’s consultation was that various market studies, including in the UK, suggest that many issuers are not currently making extensive climate-related disclosures and that there is inconsistency in how issuers interpret their obligations under existing disclosure requirements. The FCA also acknowledges the growing expectations of investors who, with the current level of disclosure, are not able to allocate capital efficiently or properly manage their exposure to climate-related risks.

To address these issues, CP 20/3 makes two key proposals:

- a new climate-related disclosure requirement in Listing Rule 9.8 that will require each premium-listed commercial company (including any sovereign-controlled commercial company) to make certain climate-related disclosures in its annual financial report; and
- a new Technical Note to clarify existing climate-related disclosures that are required to be made by all companies that are subject to the Listing Rules, Disclosure Guidance and Transparency Rules, Prospectus Regulation Rules, and/or the Market Abuse Regulation.

This memorandum considers these proposals, their potential impact on issuers and Listing Rule sponsors, and also highlights the areas that the FCA has stated in CP 20/3 that they may re-evaluate in future as practice develops both in the UK and in other jurisdictions.

Proposed amendment to Listing Rule 9.8

Under new Listing Rule 9.8.6R(8)(a), the FCA proposes that each premium-listed commercial company, whether incorporated in the UK or elsewhere, will be required to include a statement in its annual financial report setting out whether it has made disclosures consistent with the recommendations and supporting recommended disclosures set out in Section C of the [Recommendations of the Task Force on Climate-related Financial Disclosures](#) (the “TCFD Final Report”). If an issuer has not complied with these recommendations, it is required to provide an explanation for its non-compliance (LR 9.8.6R(b)(ii)).

The underlying disclosures to which the compliance statement relates may be made in any document, but CP 20/3 does state the FCA’s preference that the climate-related disclosures be made in the annual financial report itself. In its view, this will bring climate-related disclosures under the systems, controls and governance frameworks that apply to an issuer’s financial filings. To this end, the FCA has included in Listing Rule 9.8.6R(b)(i) a requirement that an issuer must explain in its annual financial report if it chooses to disclose the required information in another document and not in the annual financial report itself (LR 9.8.6R(b)(i)).

Wherever the climate-related disclosures are made, an issuer must include in its compliance statement a reference to where that information can be found (LR 9.8.6(c)).

When does the new rule take effect?

It is proposed that the new rule will take effect for financial periods beginning on or after 1 January 2021, which means that the first annual reports that will be required to comply with the proposed new rule would be published in 2022. The FCA has since announced an extension to the consultation period for CP 20/3 from 5 June 2020 until 1 October 2020, which may affect when this rule change comes into force.

What are the recommendations and the supporting recommended disclosures in the TCFD Final Report?

The Taskforce on Climate-related Financial Disclosures was established in December 2015 by the Financial Stability Board with the aim of identifying the climate-related information needs of financial services firms – investors, lenders, and insurance underwriters – and developing a set of climate-related disclosure recommendations to support these needs.

The TCFD Final Report was published in June 2017 and contains the four overarching recommendations for climate-related disclosures: governance, strategy, risk management, and metrics and targets. Underneath these four recommendations are the following supporting recommended disclosures:

- **Governance** – describe the board’s oversight of, and management’s role in assessing and managing, climate-related risks and opportunities;
- **Strategy** – describe the climate-related risks and opportunities the issuer has identified over the short, medium and long term; the impact of such risks and opportunities on the issuer’s business, strategy and financial planning; and the resilience of the issuer’s strategy, taking into account different climate-related scenarios (including a 2°C or lower scenario);
- **Risk management** – describe the issuer’s processes for identifying, assessing and managing climate-related risks; and how these processes are integrated into the issuer’s overall risk management; and
- **Metrics and targets** – disclose the metrics used by the issuer to assess climate-related risks and opportunities in line with its strategy and risk management process; and various greenhouse gas emissions and the related risks; and describe the targets used by the issuer to manage climate-related risks and opportunities and its performance against targets.

The TCFD Final Report also includes guidance for all sectors on each of the recommendations. In addition, the TCFD Final Report was published alongside two further documents:

- **Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures**, a supplementary sector-specific guidance to implement the recommendations; and
- **The Use of Scenario Analysis in Disclosure of Climate-related Risks and Opportunities**, a technical supplement.

Under CP 20/3, it is proposed that new guidance will be added in LR9.8.6BG and L.9.8.6CG that the FCA considers both of these documents relevant in determining whether an issuer’s climate-related financial disclosures are consistent with the recommendations and suggested recommended disclosures set out in the TCFD Final Report.

Asset managers

The FCA identifies that asset managers and insurance companies with asset management businesses have two distinct users of climate-related disclosures: shareholders and clients. However, the FCA makes it clear that the new rule is intended only to govern climate-related disclosures made to shareholders and that it will clarify its approach to climate-related disclosures to be made by asset managers as FCA-regulated firms to their clients in due course.

As such, for the purposes of compliance with the new rule, asset managers need only to report in a manner consistent with premium-listed issuers in other industries. They are nevertheless encouraged to make disclosures in line with the TCFD’s framework for asset managers on a voluntary basis.

What will be the impact on issuers?

Some issuers already report in line with the TCFD Final Report recommendations and have in place the internal processes to enable them to do so. These companies are, however, in the minority: the UK Financial Reporting Council’s Financial Reporting Lab reported in October 2019, in **Climate-related corporate reporting - Where to next?**, that currently only 39 per cent. of FTSE 100 constituents make any

mention of the TCFD Final Report recommendations and only 16 per cent mention climate change in the Chair/CEO statements.

Most premium-listed issuers will therefore have to make changes and the FCA places the cost of compliance for each issuer in the first year to be approximately £120,000. This cost involves the appointment of various specialists, including:

- quantitative analysts to develop scenario analysis methodology tailored to the circumstances of the business; and
- risk/sustainability analysts to develop a set of business-relevant metrics and targets and enhance disclosure on greenhouse gas emissions.

These individuals will have to source the relevant data and build systems capability to support systematic analysis and reporting. The finance team will also have to spend time developing the approach to disclosures, and seek input from the various departments within the business. Time will also have to be set aside by the board and senior management to oversee these changes and ensure they are fit for purpose.

Once the systems are in place, the FCA estimates ongoing compliance costs for issuers will be approximately £50,000 per annum.

What will be the requirements on sponsors?

The FCA has highlighted that, under Listing Rule 8, sponsors providing certain sponsor services will be required to conduct diligence on a premium-listed issuer's procedures in relation to making climate-related disclosures and the directors' understanding of their responsibilities and obligations in this regard. This diligence will be particularly important when a sponsor is appointed in connection with:

- an initial public offering, direct listing, or a transfer of securities already admitted on the Official List to the premium listing segment commercial company or sovereign-controlled company categories; and
- a class 1 transaction, whether an acquisition or disposal.

The FCA does not specify what form of diligence should be undertaken by a sponsor in satisfying its obligations.

In the first scenario, steps that a sponsor may wish to consider taking to support its confirmations to the FCA could include:

- reviewing an issuer's written procedures for making climate-related disclosures;
- a diligence meeting with the persons responsible for climate-related disclosures to understand the experience of those individuals as well as their views on the robustness and suitability of those procedures;
- the incorporation of the climate-related disclosure requirements in any "teach-in" given to directors and any supporting materials provided to them, including any memorandum of directors' responsibilities and obligations provided to directors; and
- assurance from the reporting accountants in its financial position and prospects procedures report on the company's ability to meet the climate-related disclosure requirements.

In connection with a class 1 transaction, a sponsor will want to consider the impact of the acquisition or disposal on the company's procedures for complying with the climate-related disclosure requirements to ensure that, in line with its obligation to make the relevant confirmation to the FCA, the transaction will not have an adverse impact on the issuer's ability to comply with its obligations.

In the case of an acquisition, the sponsor will want to understand how and when the issuer's existing procedures will be imposed on the acquired business, who will be responsible for the implementation and maintenance of those procedures at the acquired business, and whether the issuer's own procedures can manage the disclosure requirements of a larger business. If the acquisition relates to a company or asset in a different sector or geography to its existing businesses, it may also be the case that the company's

procedures need to change to reflect any new exposure to climate-related risks and opportunities, and the scenarios, metrics and targets the issuer has previously established may need to be reassessed. If new directors join the board as a result of the acquisition, those individuals will also need to receive training on the climate-related disclosure requirements if they are unfamiliar with them.

For a disposal, it will be a question as to whether the acquisition results in the departure or changes to the roles of individuals responsible for the issuer's procedures. If so, the sponsor will want to understand the issuer's remedy and test the appropriateness of the proposed approach. Equally, if the composition of the issuer's business has changed following a disposal, a sponsor will want to be comfortable that the issuer has properly considered whether its climate-related risks and opportunities, as well as the scenarios, metrics and targets against which the issuer reports, should be amended.

Future developments

It is clear from CP 20/3 that the FCA expects that the Listing Rules may be further amended as market practice develops to meet investor expectations with regard to climate-related disclosures. These potential changes include:

- extending the rule to include premium-listed closed-ended investment funds and open-ended investment companies, and standard-listed companies;
- making it mandatory to comply with the climate-related disclosures set out in the TCFD Final Report;
- adding additional specificity to the disclosure requirements as further guidance is published by the TCFD and industry initiatives to support implementation of the recommendations conclude; and
- making climate-related disclosures subject to third-party assurance.

New Technical Note on existing disclosure obligations

The purpose of the proposed new Technical Note is to clarify what issuers subject to the Listing Rules, Prospectus Regulation Rules, the Disclosure Guidance and Transparency Rules and Market Abuse Regulation are expected to consider with regard to their ESG-related disclosures.

The intention of the FCA in this Technical Note is to highlight those existing requirements in one place, and also try to encourage a consistent approach to the disclosures made by issuers. Whilst there is nothing new in the Technical Note, it does provide issuers with clear guidance as to their obligations and removes potential uncertainty as to what is required of them.

Two areas of particular focus in the guidance are the adequacy of an issuer's procedures, systems and controls to make ESG-related disclosures, and the ESG disclosures that should be considered for inclusion in prospectuses and, for premium-listed issuers, shareholder circulars.

Systems and controls to make ESG-related disclosures

Listing Principle 1 establishes that all issuers with securities admitted to the Official List must have adequate procedures, systems and controls to enable them to comply with their obligations. The proposed Technical Note indicates, irrespective of whether it needs to comply with the new Listing Rule 9.8, an issuer should consider whether there is a need to access and draw on specific data when disclosing climate-related and other ESG-related risks and opportunities to the market. To support this, an issuer should consider if it should develop specific systems, analytic instruments or organizational arrangements to collate and assess information required to enable it to comply with its obligations. In essence, this could mean that the FCA expects a standard-listed issuer or closed-ended investment fund or open-ended investment company to implement systems and controls that are not too dissimilar to those required by issuers who must comply with the new disclosure requirements under Listing Rule 9.8.

ESG disclosure in prospectuses and shareholder circulars

The new Technical Note states that issuers consider the relevance of ESG-related matters when seeking to comply with the overarching disclosure standard for any prospectus, which is that it must contain the

necessary information which is material to an investor in making an informed assessment of, amongst other things, the assets and prospects of the issuer. It also highlights particular disclosure requirements for prospectuses as well as the associated guidance from the European Securities and Markets Association (“ESMA”), including:

- Recital 54 of the Prospectus Regulation, which states that environmental, social and governance circumstances can constitute specific and material risks for an issuer and its securities and that such circumstances should be disclosed in the risk factors;
- Item 5.7.4 of Annex I of the Commission Delegated Prospectus Regulation, which requires an issuer to describe any environmental issues that may affect the issuer’s utilisation of tangible fixed assets;
- Item 9.1 of Annex I of the same delegated regulation, which requires an issuer to describe the regulatory environment (which includes environmental matters) in which it operates and which may materially affect its business; and
- paragraphs 28, 50, 131 to 133 and Appendices I, II, and III of the ESMA update of the CESR recommendations, which provide guidance on environmental key performance indicators in the context of an issuer’s operating and financial review and the identification of factors to consider when preparing a profit forecast, as well as specific requirements for mineral companies.

With regard to circulars published by premium-listed companies, the FCA notes that a circular must provide a clear and adequate explanation of its subject matter giving due prominence to its essential characteristics, benefits and risks, and must contain all information necessary to allow the security holders to make a properly informed decision. The Technical Note states that this may require the inclusion of information on ESG matters.

On the basis that the FCA has chosen to focus on these provisions, it is perhaps to be expected that these areas will be subject to particular scrutiny during the FCA document review process in future.

Next steps

The consultation period for CP 20/3 was originally scheduled to close by 5 June 2020, but this has now been delayed until 1 October 2020. As mentioned above, the proposed amendment to Listing Rule 9.8 is anticipated to take effect for financial years beginning on or after 1 January 2021, but it is unclear what affect the delay to the consultation process will have on the rules coming into force. There has been no timeframe published for the publication of the final Technical Note and it may well be published prior to the rule change.

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