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Thorben Heidrich
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Sent by email to cp21-18@fca.org.uk

17 September 2021

Dear Thorben,

Enhancing climate-related disclosures by standard listed companies and seeking views on ESG topics in capital markets

I am writing to respond to the Financial Conduct Authority's consultation *Enhancing climate-related disclosures by standard listed companies and seeking views on ESG topics in capital markets*, on behalf of ShareAction, a registered charity established to promote transparency and responsible investment practices by pension funds and other institutional investors. We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 26,000 individual supporters. Among other activities, we work with the financial services sector to promote integration of sustainability factors in investment decisions, long-term stewardship of assets and the consideration of the views of clients, beneficiaries and pension scheme members.

We welcome the work that has been done by the FCA in enhancing climate-related disclosures by standard listed companies and seeking views on ESG topics in capital markets. We have provided specific comments in response to the questions below on the FCA's proposals for reporting. We also wish to make the following broader points:

- **Enforcement:** The FCA should ensure that it has the powers and capacity to review and assess climate-related reporting, as well as taking appropriate enforcement action where reporting is not of an acceptable standard. Without proper resourcing to do this work, the purpose of climate reporting risks being undermined. We would recommend that the FCA undertakes a review of the effectiveness of reporting, following the first cycle of reporting.
- **Risk management and portfolio alignment:** We welcome the FCA's intention to refer to TCFD guidance on transition plans. However, we believe there should be a clearer distinction between risk management (assessing physical and transition risks for the firm) and portfolio alignment (assessing progress to meet the goals of the Paris Agreement / deliver a net zero ambition and report on intended pathway to meet these goals). The FCA should encourage financial institutions to rely on a credible 1.5C aligned scenario to define alignment and/or set targets.
- **Guidance:** We understand that the FCA is introducing a new 'Environmental, Social and Governance (ESG) Sourcebook' in the FCA Handbook to set out proposed rules and guidance. We would like to know if the wording of the rules and guidance will be subject to public consultation, as with guidance produced by the Department of Work of Pensions 2 (DWP). Clearly much of the effectiveness of climate reporting will depend on the detail of rules and guidance, so we believe it is appropriate for this to be subject to public comment.

Q1: Do you agree with our proposal to extend the application of our existing TCFD-aligned disclosure requirement (set out in LR 9.8.6R(8)) to issuers of standard listed equity shares, excluding standard listed investment entities and shell companies? If not, what alternative scope would you consider to be appropriate, and why?

We agree with the extension of the application of the existing TCFD-aligned disclosure requirement to issuers of standard listed equity shares. However, it would be welcome to see a consistent approach taken across all asset classes. For example, while a “shell company” and SPAC (Special Purpose Acquisition Company) are different entities, we see similarities in the structures and have concerns that excluding shell companies from the scope of these proposals would allow some loopholes for greenwashing. However, if the FCA chooses not to include them within the scope of these proposals at this stage, we would suggest committing to a yearly review to make sure that the system is not being exploited.

Q2: Do you consider that issuers of standard listed GDRs and standard listed issuers of shares other than equity shares should also be subject to our TCFD-aligned disclosure requirements? If not, what alternative approach would you consider to be appropriate, and why?

We agree issuers of standard listed GDRs should also be considered for inclusion within the extended application of disclosure requirements. We would also suggest that standard listed issuers of shares other than equity shares should be included in the extended application of the proposed rule. The resilience of these issuers to climate risk is of interest to investors and other stakeholders in a similar way to the holders of equity shares. We believe TCFD should be applied as holistically as possible across asset classes, as this will allow for standardisation and transparency for investors and their clients.

Q3: We welcome views from market participants on whether to apply TCFD-aligned disclosure rules to issuers of standard listed debt (and debt-like) securities, and how best to do this. In particular, we seek input on the following:

We would like to know, in reference to paragraph 3.23, if there is no separate category for “commercial company” issuers of standard listed debt and debt-like securities, could the FCA envisage creating one?

a. What climate-related information from issuers of these securities would market participants find decision useful and how far would these information needs be met by TCFD-aligned disclosures?

Investors in listed debt need to obtain information about issuers’ governance, strategy, risk management, metrics and targets related to climate risk in a similar way to investors in equities. In our 2019 report, *Sleeping Giants: Are Bond Investors Ready to Act on Climate Change?*,[1] we found that ESG risk was seen almost universally as relevant to bond investment. At the same time, interviewees said they did not have the data needed to make ESG and climate change integral parts of their investment decision making process.

Information not covered by the TCFD framework but that would be useful for disclosure from issuers of listed debt includes:

- **Governance** – Examples of how the board is trained/educated on climate matters.
- **Capex/Use of proceeds** – if relevant, if any climate considerations have been taken prior to the capital raise and expected impact positive or negative on climate as a result. Can the company demonstrate their forward looking capex is aligned to 1.5C? How does this debt raising align with that strategy?

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[1] https://shareaction.org/wp-content/uploads/2019/01/Sleeping-Giants.pdf

- Is debt being raised to address a specific climate risk/concern? Has any scenario analysis been done to forecast if this raising would provide sufficient capital?

b. Do market participants' information needs differ according to the different types of issuer in LR 17?

Market participants' information needs will vary across all the different kinds of issuer, within LR 17 and beyond it. TCFD reporting should still be made mandatory across the board, since the framework should be flexible enough to accommodate these differing information needs.

c. If you consider that we should apply TCFD-aligned disclosures rules to issuers of standard listed debt (and debt-like) securities, should some issuer types be excluded from the rule to deliver an effective and proportionate approach? If so, which types of issuers should be included/excluded and how can the scope best be defined?

Please see our answer to question 3b.

d. Are there any other matters we should take into consideration – eg, competitiveness, complexity of the application of the rule, burden on issuers in LR 17, or the feasibility to comply with any potential rules?

Please see our answer to question 3b. In addition, climate reporting should be a normal cost of doing business for any regulated entity and will be far outweighed by the financial detriment of runaway climate change.

Q4: Do you agree with our proposal to mirror the structure and wording of LR 9.8.6R(8) and LR 9.8.6BG to LR 9.8.6EG for companies with a UK premium listing? If not, what alternative approach would you consider to be appropriate, and why?

We do not agree that the wording of these rules should be mirrored to the extent that a 'comply or explain' approach is maintained. Please see our answer to question 8 for more detail.

We believe that the FCA should use the wording of these rules to require companies to ensure that their transition plans are consistent with Paris Goals, relying on a credible 1.5C aligned scenario to define alignment and/or set targets. While we support the FCA's reference to TCFD guidance on transition plans, we have some concerns about the clarity and extent of this guidance, as set out in our answer to question 5.

Q5: Do you agree that, subject to the TCFD's final guidance materials being broadly consistent with those proposed, we should incorporate them into our existing and proposed handbook guidance provisions as described (including both the existing guidance relating to LR 9.8.6R(8) and our proposed new guidance relating to LR 14.3.27R): a. the TCFD's proposed updates to the TCFD Final Report and TCFD Annex b. the TCFD's proposed standalone guidance document on metrics, targets and transition planning c. the TCFD's technical supplement on measuring portfolio alignment. If not, what alternative approach would you prefer?

We welcome the FCA's intention to refer to TCFD guidance, particularly on transition plans, in assessing whether firms' climate-related financial disclosures are consistent with TCFD Recommendations.

We are aware that the TCFD's guidance on metrics, targets and transition plans is yet to be finalised and we have fed our views back to them directly. However, we think it would be worth sharing these views here as well. These were our main comments on the TCFD's guidance:

- **Using a climate scenario aligned with a reliable 1.5C pathway:** While the report discusses the difference between exploratory and normative scenarios, it could be more explicit on what a "preferred future" should be and the implications of different pathways to get there. "Paris-alignment" can and has been interpreted in different ways (e.g. from low 1.5C to high 2C warming) which has important consequences on the companies' climate strategy, transition plans and targets. The TCFD should encourage its audience to use climate scenarios compatible with a reliable 1.5C pathway (defined as a 1.5°C outcome with no or limited overshoot and limited reliance on negative emission technologies).
- **Disclosing climate scenario's underlying assumptions:** Financial institutions should also disclose the underlying scenario's assumptions (including temperature outcome, probability, reliance on offsets, Carbon Capture Storage, Negative Emission Technologies) so that stakeholders can assess the credibility of their approach. Simply stating that a scenario is or is not "Paris aligned" or "net-zero aligned" is not sufficient for users to make a judgement on the company's target. The consultation paper should also remind the audience of the need to make realistic assumptions in terms of technologies not yet available at scale or presenting important social and environmental risks (e.g. negative emissions technologies) as highlighted by the IPCC's special report on 1.5C.
- **Going beyond what the climate scenario suggests:** considering the uncertainties associated with both climate and portfolio modelling, financial institutions should aim to go beyond what the models suggests and allow for an additional "buffer" when setting climate related targets and/or measuring alignment. This buffer should take into account the probability associated with the scenario's carbon budget and any other caveat relating to the pathway the company or financial institutions is relying on (e.g. the IEA's Net Zero scenario makes unrealistic assumptions around deployment of CCS over the next 10 years. A financial institution should take this into account when setting a target for its energy portfolio and not simply "track" the scenario.
- **Complementing metrics and targets with robust sectoral policies:** Financial institutions should be reminded that metrics and targets will not necessarily prevent them from allocating capital to activities that are not Paris-aligned. A robust sector policy framework for the most carbon intensive sectors (e.g. thermal coal) is therefore necessary to complement the model. Sector policies and transition plan assessment frameworks should be articulated around clear expectations for clients' transition plans failing which they will be excluded within a specific timeframe. In addition to the above, we were not sure if the FCA is asking firms to disclose their assumptions in reporting on their progress against targets. For example, it would be important to know what scenario the firm is using, how the firm sees this scenario, and whether it is reliant on technology such as carbon negative technology that does not exist.

Q6: Do you agree that we should update the Technical Note 801.1 to reflect the proposed new rule and associated guidance in this CP?

We agree.

Q7: Do you agree with our encouraging listed companies to consider the SASB metrics for their sector when making their disclosures against the TCFD's recommended disclosures, as appropriate? If not, please explain.

We would not recommend encouraging listed companies to consider the SASB metrics in this context. We feel they would not be useful in supporting TCFD reporting for the following reasons: SASB metrics are topic-based rather than being based on materiality; they tend to be backwards rather than forwards-facing; and they require companies to report very limited amounts of information so are unlikely to improve the level of detail in reporting. We would highlight that SASB are not the only voluntary reporting standards available: others, such as CDSB, may be worth considering.

Q8: Do you agree with our approach to maintain a 'comply or explain' compliance basis until such time as a common international reporting standard has been published and adopted in the UK? If not, what alternative approach would you prefer, and why?

No, we do not agree that the rules should be introduced on a 'comply or explain' basis. A common international reporting standard is not required for companies to disclose climate-related information. Investors and other stakeholders are entitled to receive such information given the significant impact it will have on their financial and broader concerns. Investors also have their own duties to disclose, which will be made far more difficult if their investee companies are not required to do so.

These rules should be introduced on a mandatory basis without delay: this is commensurate with the urgency of reducing emissions and averting the worst effects of the climate crisis, as emphasised in the IPCC's 2021 report.[2] Rules can then be adapted further down the line as and when an international reporting standard has been finalised. However, we cannot wait any longer for this information to be made public across the board.

Q9: Do you agree with our approach not to require third-party audit and assurance for issuers' climate-related disclosures at this time? If not, what additional requirements would you consider to be appropriate?

As proposed by ClientEarth in their own response, we recommend that auditors are required to provide a 'limited assurance' opinion in relation to climate-related disclosures included in the annual report. This will provide investors and other stakeholders with greater confidence that the information can be trusted.

Q10: Do you agree that our new rule should take affect for accounting periods beginning on or after 1 January 2022? If you consider that we should set a different timeframe, please explain why.

We agree.

Q11: Do you agree with the conclusions and analysis set out in our cost benefit analysis (Annex 2)?

We believe that any cost of climate reporting for business is immeasurably outweighed by the cost that would befall it, together with communities and the environment, if the climate crisis goes unchecked.

Q12: If future changes were considered in relation to the UK prospectus regime, we would welcome views on also taking the opportunity to introduce specific requirements in relation to UoP bond frameworks and their sustainability characteristics?

No view.

Q13: Should the FCA explore supporting the UoP bond market by recognising existing standards (eg, ICMA Principles), potentially through our recognition of industry codes criteria and process?

No view.

Q14: We would also welcome views on more ambitious measures the FCA could consider, for example to require that the central elements of UoP bonds be reflected in contractual agreements and set out in the prospectus

[2] https://www.ipcc.ch/report/ar6/wg1/

No view.

Q15: We would welcome views on the potential harm set out above and what, if any, actions the FCA or the Treasury should consider.

No view.

Q16: Should the FCA, alongside the Treasury, consider the development and creation of a UK bond standard, starting with green bonds?

No view.

Q17: Do you agree with how we have characterised the challenges and potential harms arising from the role played by ESG data and rating providers? If not, please explain what other challenges or harms might arise?

We agree.

Q18: Would further guidance for firms on their use of ESG ratings – and potentially other third-party ESG data – be useful, potentially clarifying expectations on outsourcing arrangements, due diligence, disclosure and the use of ratings in benchmarks and indices? Are there other aspects such guidance should include?

We would support creating guidance for firms on their use of ESG ratings and data. However, we do not believe that this would be sufficient to address the issues identified in this consultation paper.

Q19: We would welcome views on whether there is a case either to encourage ESG data and rating providers to adopt a voluntary Best Practice Code, or for the FCA to engage with the Treasury to encourage bringing ESG data and rating providers' activities inside the FCA's regulatory perimeter.

We would recommend that the FCA engages with the Treasury on bringing ESG data and rating provider activities within the FCA's regulatory scope.

Q20: If there is a case for closer regulatory oversight of ESG data and rating providers, we welcome views on:

a. Whether transparency, governance and management of conflicts of interest are the right aspects of ESG data and rating providers' operations and activities to prioritise in regulatory oversight, and if not, what other aspects should be considered

No view.

b. Whether and how regulatory priorities should differ between ESG rating providers and other ESG data providers c. The similarities and differences between the policy issues that arise for ESG rating providers and those that arise for CRAs, and how far these similarities and differences might inform the appropriate policy response

No view.

Q21: What other ESG topics do you consider that we should be prioritising to support our strategic objective? Please explain.

No view.

Yours sincerely,

Rachel Haworth
Policy Manager, ShareAction