

Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations

Consultation Paper

CP20/3** March 2020

Response from the [Corporate & Financial Law Research Group, University of Glasgow](#)

1. **Q1:** Do you agree that our new rule should apply only to commercial companies with a premium listing, at least initially? If not, what alternative scope would you consider to be appropriate, and why?

Yes. The TCFD recommendations fit better with operating companies rather than investment companies. The latter will in due course fall within the scope of the EU taxonomy and its related Regulation. But it's not clear why a distinction is drawn between asset managers and investment trusts (listed, closed-end investment companies), especially as the latter can be a substantial part of the business of the former.

2. **Q2:** Do you agree that sovereign-controlled commercial companies with a premium listing should also be in scope? If not, why should these companies not be included?

Yes. That process can help to align the relevant states with the TCFD recommendations.

3. **Q3:** Do you agree with our approach?

In broad terms, there's an issue of double reporting as between 'commercial' companies reporting on their operations and asset managers reporting on their portfolios. Will this be done on a 'pass through' basis, with asset managers just acting as a conduit, or will they make their own evaluations? (Seems like the latter. If so, there is a risk of divergence and confusion.)

4. **Q4:** Do you agree that our rule should reference the 4 recommendations and 11 supporting recommended disclosures included in the TCFD's June 2017 final report? If not, what alternative approach would you prefer, and why?

Yes, there is merit in referencing the TCFD recommendations in their entirety to preserve their unity and coherence.

5. **Q5:** Do you agree that we should make explicit reference in Handbook guidance to the TCFD's "guidance for all sectors" as well as the "supplemental guidance for the financial sector" and the "supplemental guidance for

non-financial groups” accompanying each recommended disclosure? If not, what alternative approach would you prefer, and why?

Yes. This will facilitate effective disclosure by issuers.

6. **Q6:** Do you agree that we should include additional guidance which references the wider set of materials that have been published both within and alongside the TCFD’s final report, as useful sources of guidance and interpretation when complying with our proposed rule?

Yes. Guidance works well where issuers have some discretion. These materials might be referenced in any case by issuers and their advisers, but this would make them more accessible.

7. **Q7:** Do you agree that we should introduce the new rule on a ‘comply or explain’ basis? If not, what alternative approach would you prefer, and why?

We have reservations about this. It’s interesting that this question is posed under the heading of ‘proportionality’ rather than ‘design of the rule’. In our view it is part of rule design and represents a technique for introducing flexibility into rule design to cope with uncertainty over the best solution to be applied to a given problem. That’s how the ‘comply or explain’ principle first emerged from the Cadbury Committee in the early 1990s. It facilitated flexibility in governance structure in a way that was not so easily achieved within the conventional taxonomy of rules in corporate law, recognising that governance structure should be configured according to the different circumstances of firms. So, the first question with climate-related disclosure is whether there is a comparable degree of uncertainty as to the utility or feasibility of disclosure that would trigger a role for ‘comply or explain’. We don’t see much evidence of equivocation as to the benefits in the approach of the TCFD or the FCA and so the case for ‘comply or explain’ is not obvious.

Moreover, if the FCA intends to be aligned with the UK Government’s Green Finance Strategy, which expects all listed companies to disclose climate-related financial risks by 2022, the actual timeframe in which the comply or explain approach will be in place will be relatively short. This raises the question of whether outright compliance may not be a better approach. It’s not clear how making the disclosure of climate-related financial risks in line with the TCFD’s recommendations compulsory would thwart the TCFD initiative itself. If anything, it would reinforce it, by giving it credibility in the eyes of financial supervisors in other jurisdictions. Indeed, countries such as France already make disclosure in line with the TCFD recommendations compulsory.

With regard to the ‘proportionality’ issue, the case for ‘comply or explain’ is that a mandatory rule might force issuers to make disclosures that they cannot support. But a ‘rule of reason’ approach would simply exclude the obligation to disclose what cannot be accurately disclosed (a ‘rule of reason’ would not regard it as ‘information’ if it cannot be reliably verified).¹ That is what we understand the practice to be with regard to the disclosure of ‘material’ financial information, and that approach will remain in place after this proposal is implemented. Adopting a ‘comply or explain’ approach for climate-related disclosures only will likely lead to confusion and lack of coherence across the disclosure regime for listed companies. There is an element of

¹ The ‘rule of reason’ is not discussed so much nowadays but it was influential in the early stages of the evolution of EU law as a technique to set proportionality limits to the application of rules— see eg *Cassis de Dijon*, Case 120/78, [1979] ECR 649.

that already present in the ‘comply or explain’ element of the strategic report section on environment etc.² but its effect is not so pervasive as the overlap with financial reporting is less extensive.

There’s also the issue of whether, in this context, ‘comply or explain’ would provide the sort of disciplinary mechanism that it does in the context of corporate governance, where the exit (sell out) option is present. Arguably so, in that exit is a possible outcome. But the evaluation for (institutional) shareholders is much more complex as there is no clear comparator as there is in the case of the UK Corporate Governance Code. Thus, there is no way to know what the counterfactual to compliance is: in the case of the Code it is the standard governance structure set by the Code, followed by almost all companies, with relatively few instances of deviance triggering the need for an explanation; in the case of climate-related disclosure the counterfactual is unknown, and cannot logically be demonstrated by an explanation (otherwise it would have to be disclosed). Thus, the function and utility of the ‘comply or explain’ principle in this context is obscure. As has occurred in other instances, the presumption that the ‘comply or explain’ technique can easily be transplanted across different regulatory regimes is very questionable.

8. **Q8:** Do you agree that the recommended disclosures under the “governance” and “risk management” recommendations should not be subject to a materiality assessment? If not, what alternative approach would you prefer, and why?

There is a (seemingly) implicit assumption in parts of the consultation that there is a clear divide between financial disclosure and TCFD-linked climate disclosure. But there can’t be such a division as neither set of disclosures is limited in scope in that way. So, having different disclosure thresholds within climate disclosure will mean that the overlap with financial disclosure is asymmetric and complex. And integrating TCFD disclosures into financial reporting, while good in itself, will just exacerbate that problem as it will not be clear what is driving the disclosure and the standards that it should meet.

9. **Q9:** Do you agree that issuers should ordinarily be able to make the recommended disclosures under the “governance” and “risk management” recommendations?

Yes.

10. **Q10:** Do you agree that no explicit guidance is needed to clarify that it would be acceptable for an issuer to explain non-disclosure of these recommended disclosures only on an exceptional basis?

No. The point of ‘comply or explain’ is to deliver flexibility rather than exceptionalism, which can be embedded in other rule types (such as the materiality standard for

² Information relating to, as a minimum: environmental matters, the company’s employees, social matters, respect for human rights and anti-corruption and anti-bribery matters (s 414CB (1) and (4) CA 2006). See generally Irene-marié Esser, Iain MacNeil and Katarzyna Chalaczkiwicz-Lada, “Engaging stakeholders in corporate decision-making through strategic reporting: an empirical study of FTSE 100 companies (Part 1)” 29(5) *European Business Law Review* 729–772 (2018); (Part 2, Vol 31(2) (2020) pp. 209 – 242).

financial disclosure, which implicitly incorporates an exception for non-material information). Therefore, this is too restrictive. It would be more sensible to focus on appropriateness and proportionality rather than exceptionalism.

11. **Q11:** Do you agree that the statement of compliance and the proposed disclosures should be made within an issuer's annual financial report? If not, what alternative approach would you prefer and why?

Yes, subject to risks mentioned at q8 above, it is sensible to have integrated disclosure.

However, there is a further aspect to be considered here. As noted at para 4.41 of the consultation, the TCFD recommends that climate-related disclosures be made in an organisation's mainstream financial filings except where that is incompatible with the rules of the jurisdiction. In the UK, limiting disclosures in that way is likely to be incompatible with the listing rules requiring periodic (interim) and on-going disclosures (as set out in Part 5 and the Appendix 2, Technical Note in the consultation). Thus, there are likely to be overlapping disclosures that are required by existing mandatory rules (prospectus, periodic and continuing obligations) and the proposed TCFD-driven 'comply or explain' proposed rule. While it might be argued that this structure will incentivise a more expansive approach to the mandatory disclosure rules, it is just as likely that the 'explain' safe harbour may encourage a more restrictive approach. Whatever the outcome, the overlap is more complex than it need be and is likely to obscure performance against relevant disclosure obligations. The solution proposed at Q16 would be a more realistic option.

12. **Q12:** Do you agree that an issuer should be required to include within the statement of compliance a description of where in its annual financial report (or other relevant document) its TCFD-aligned disclosures can be found? If not, what alternative approach would you prefer and why?

Yes. They should be located with other relevant disclosures to deliver integrated reporting. But see responses to Q8 and Q11 re overlap.

13. **Q13:** Do you agree that the FCA should not require third-party assurance of issuers' climate-related disclosures at this time? More generally, we welcome views on the role of assurance for climate-related disclosures.

Yes. In any case, material disclosures will fall within the scope of the existing audit process.

14. **Q14:** Do you have any feedback on the interactions between our proposed rule and the role of sponsors in assisting premium listed issuers?

N/a

15. **Q15:** Do you have any other feedback related to the interaction between our proposed rule and existing legislative and regulatory requirements and industry standards and practice?

Further consideration should be given to interaction between the proposed rule and the UK Corporate Governance Code. For example, provision 1 requires the board to describe in the annual report "how opportunities and risks to the future success of the

business have been considered and addressed". That arguably already encompasses much of the TCFD recommendation on governance and risk management. Similarly, elements of the TCFD Strategy recommendation and disclosures are already covered by the strategic report.

So, there's a risk of overlapping disclosure requirements, leading to confusion as to what is being actioned and disclosed under any given regime. As well as concern over liability for directors with compliance and reporting requirements.

We conducted an extensive study on the 'strategic reporting' provisions of the UK Companies Act 2006,³ measuring compliance with the statutory requirements for a strategic report, especially the extent to which suppliers, environmental considerations, social, community and human rights bodies are considered by the companies. We found that compliance with those requirements was very high, amounting even to super or overcompliance. A holistic approach is however lacking, there is a lot of repetition of information in the reports (often more than one report) and the reports are not well structured. A full integration of financial and non-financial information for strategic reporting is required. The empirical research suggested that the production of various additional non-financial reports could be counterproductive. The repetition of information in the strategic reports and additional CSR reports was not rare and it was often time consuming and challenging to analyse the company's policies on a given nonfinancial matter, as the study of several reports was necessary.

These considerations should be taken into account in the context of additional climate-related disclosures. One of our concerns is the link with other non-financial reporting requirements, such as the strategic reporting requirements as per the Companies Act, 2006. In the context of those requirements certain companies have to disclose on environmental matters on a comply or explain basis already (s 414C (7) (b) CA 2006)). It is not clear how disclosure on climate-related issues, also on a comply or explain basis, applying to the same set of companies, is any different. Why do we need to have this additional layer of disclosure? We would argue that factors such as which companies will be subject to the disclosure requirements, the basis of disclosure (i.e., 'comply or explain' or mandatory), the contents of the disclosure (climate-related disclosure is more precise than disclosure on 'environmental matters') and where the disclosure has to take place are the differentiating factors and should be re-evaluated to make this disclosure meaningful in the light of the strategic reporting requirements.

16. **Q16:** Do you consider that our proposals adequately address the challenges, risks and unintended consequences described above? If not, what additional measures would you suggest?

It's hard to say at this stage. It may have been simpler at this stage to tweak the strategic report so as to include TCFD disclosures, as the relevant section already operates on a comply or explain basis (see response to Q7).

In order to address the structural complexity of climate change, the FCA could include additional guidance akin to that described in Q&A that identifies references that the FCA will consider to be reference scientific knowledge, e.g. reports prepared

³ See source at fn 2 above.

by the Inter-governmental Panel on Climate Change and reports published by the Energy and Climate Change Committee and the Environmental Audit Committee, to name a few. What scientific knowledge is “accepted” by the global community in relation to climate change has been very controversial for the past 40 years and is likely to remain so in the near future. Identifying specific references will allow the FCA to establish a minimum floor of what is considered to be accepted scientific knowledge for the purposes of compliance with the proposed rules. In doing so, the FCA should ensure that the identification of these resources is the result of a coordinated approach with the UK government, as reflected in its Green Finance Strategy, for example.

17. **Q17:** Do you agree that our new rule should take effect for accounting periods beginning on or after 1 January 2021? If you consider that we should set a different timeframe, please explain why?

N/a

18. **Q18:** Do you agree with the conclusion and analysis set out in our cost benefit analysis (Annex 2)?

The CBA does not consider other options such as that set out in the response to q16 above. And the benefits are evaluated very much on a ‘back of the envelope’ basis without considering (as shown in figure 5) that many companies already disclose in line with TCFD recommendations.

19. **Q19:** Do you agree with the guidance provided in the draft Technical Note set out in Appendix 2? Are there any changes that you would suggest? If so, please describe.

N/a

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