CLIMATE FINANCIAL RISK FORUM

CLIMATE FINANCIAL RISK FORUM GUIDE 2021

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This document represents the output from the Disclosures Working Group, part of the Climate Financial Risk Forum (CFRF). It covers management of legal risk in relation to climate-related reporting requirements applicable to UK financial institutions.

This CFRF guide has been written by industry, for industry. It reflects UK climate-related disclosure rules and published proposals for climate disclosure prior to September 2021. The recommendations in and contents of this guide do not constitute financial, legal, or other professional advice and should not be relied upon as such. The PRA and FCA have convened and facilitated CFRF discussions but do not accept liability for the views expressed in this guide which do not necessarily represent the view of the regulators and in any case do not constitute regulatory guidance.

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The Disclosures Working Group was chaired by Saker Nusseibeh, CEO, the international business of Federated Hermes and co-ordinated by Ed Baker and Jodi-Ann Wang, Principles for Responsible Investment, and Kate Fowler and Gemma Corrigan, the international business of Federated Hermes.

While all members were involved in the development of the Disclosures Working Group outputs, this document does not necessarily represent the views of all firms involved.

Purpose of the Climate Financial Risk Forum

Introduction/Scope

This paper forms part of a suite of broader guidance for financial institutions focused on climate disclosure and includes discussion of managing the risk of litigation or liability related to climate disclosure.

One of the policy drivers for mandating climate disclosure is to focus attention on climate change considerations and through this to provide information that enables the allocation of capital to activities which are low carbon or are transitioning from a high to a lower carbon model or are making a positive contribution to the climate transition. However, the essence of this change is that it requires accurate information and analysis in respect of matters which financial institutions have not previously had to report upon in the same detail as traditional financial information. Accordingly, this paper first addresses the current challenges for financial institutions in this shifting environment, and the litigation risks that arise in the event of misreporting or reporting failures in the United Kingdom, the United States and other markets. It then goes on to discuss best practice options for reporting during this period of change. The annex sets out (i) the different Task Force on Climate-Related Financial Disclosures ("**TCFD**") regimes under development in the UK for listed companies, asset managers, life insurance companies and large unlisted companies, public interest entities and limited liability partnerships and (ii) a glossary of terms used in the chapter.

Rapid roll out of a global standard that supplements the TCFD methodology, adopted both nationally and internationally, would go a long way to smoothing the current transition from the voluntary "alphabet soup" world of reporting to a consistent, regulated approach.

As regulatory expectations develop across the globe, the short-term issues that reporting entities are engaging with as regards access to data and lack of commonality of methodologies is expected to improve. There is an opportunity with COP26 to speed up the generation of methodologies and tools to report on climate change.

Rapid roll-out of a global standard that supplements the TCFD methodology, adopted both nationally and internationally, would go a long way to smoothing the current transition from the voluntary "alphabet soup" world of reporting to a consistent, regulated approach.

Executive Summary

In the UK, financial institutions will start to face legal and regulatory obligations from 2022 to make climate-related financial disclosure pursuant to the recommendations of the TCFD and under other regimes.

In the banking, asset management and insurance sectors, material climate-related financial risks and exposures will be those attributable to the aggregate physical, transition and litigation risks associated with the institution's investments, assets under management, trading positions, loan books and financial or insurance products and services.

Financial institutions acknowledge the value and need for climate-related reporting and for the development of improved data and improved competencies in climate change reporting. They are, however, aware of the rigour required in respect of financial disclosures and there is concern about the current weakness of available climate-related data to support these from the reporting institutions' counterparties and data providers, even as they are mandated as part of the annual report. There is keen interest in a rapid progression of the ESG work of the International Financial Reporting Standards ("**IFRS**") Foundation.

In light of relative market immaturity, institutions consistently report a concern that any data and metrics they prepare based on third-party information may be directionally correct but inaccurate in detail. Their concern is that these disclosures will attract litigation and liability risk for reporting entities not simply in their home jurisdiction but potentially in any jurisdictions in which investors are based. Areas of concern are discussed in section 1, and litigation risks in section 2 of the paper.

To manage their own risk of litigation or liability and to make accurate disclosure based on evolving climate data and reporting capability, financial institutions will need to include clear disclosure as to this context, their own approach and methodology and how data is sourced. They will also need to specify their view as to the limitations of any data and metrics disclosed. Given current uncertainties they will wish to include disclaimer wording in respect of these disclosures. Best practice options in relation to these and other issues are set out in section 3. The annex sets out in brief summary form the different TCFD regimes under development in the UK for listed companies, asset managers, life insurance companies and large unlisted companies, public interest entities and limited liability partnerships, and the trustees of large occupational pension schemes.

Methodology

The DWG has discussed approaches to climate change-related disclosures within the working group with a particular focus on how to manage areas of concern. The group has also held three roundtables for banks, asset managers and insurance companies respectively over the period June – July 2021. Discussions were held under the Chatham House rule. Participants were asked to share good practice, areas of concern and how these could be mitigated. The examples of good practice and challenges identified in this paper represent those discussed by and with participating institutions at the DWG roundtables and in other DWG meetings. The DWG would like to thank all participants for their time and engagement.

1 Challenges of climate-related reporting specific to financial institutions

1.1 The reporting explosion

The disclosure chapter of the 2020 CFRF Guide[1] identified roughly 20 existing or incoming regulatory reporting requirements in the UK and the EU which capture ESG factors as part of general or specific disclosures.

This list did not include voluntary standards. It was already clear that the landscape for disclosure was crowded and would become more so over time. Over the last year, the move towards mandatory climate-related reporting has continued at pace and financial institutions are facing a period of rapid change in their regulatory obligations in this area.

[1] Climate Financial Risk Forum Guide 2020 - Disclosures chapter (fca.org.uk)

In the UK, it is now government policy to roll out disclosure requirements aligned to the recommendations of the TCFD.[2] The TCFD itself has been consulting on proposed guidance in respect of climate change-related metrics and targets and announced its final form of the new guidance in Autumn 2021.

Over the last year, the move towards mandatory climate-related reporting has continued at pace and financial institutions are facing a period of rapid change in their regulatory obligations in this area.

In the EU, reporting by financial institutions will be required pursuant to several different regimes, including Article 8 of the Taxonomy Regulation and the proposed Corporate Sustainability Reporting Directive ("**CSRD**"), which will update the Non-Financial Reporting Directive to expand significantly both the information to be reported and the companies required to report. Disclosure obligations under both the Taxonomy Regulation and CSRD will build over the next three years at entity level. In the EU and, in due course, in the UK, product level disclosure requirements will also apply.

The Biden administration has been consulting in the US on action to require public companies to disclose climate risks and greenhouse gas emissions in their operations and supply chains.[3] On 28 July 2021, SEC Chair Gary Gensler stated that he had directed SEC staff to develop a mandatory climate risk disclosure rule proposal for the Commission's consideration by the end of the year, taking into consideration the following:

1.1.1 whether new disclosures should be filed in the annual report (Form 10-K);

1.1.2 whether a variety of qualitative and quantitative information should be provided by companies, such as how company leadership manages climate-related risks and emissions, impacts of climate change and progress towards goals; and

1.1.3 whether metrics should vary given differing industries (such as banking, insurance, or transportation).[4]

Chair Gensler has also argued that investors should be able to "see what's under the hood" of funds marketed as "green" or "sustainable" and has asked SEC staff to consider whether fund managers should disclose the criteria and underlying data they use.[5]

As part of the Biden Administration's sweeping 20 May 2021 Executive Order on Climate-Related Financial Risk, federal agencies (including the Federal Reserve, SEC, and others) are required to issue a report in Autumn 2021 considering "the necessity of any actions to enhance climate-related disclosures by regulated entities to mitigate climate-related financial risk to the financial system or assets and a recommended implementation plan for taking those actions."[6]

Similar requirements have recently been introduced in other markets, including for asset managers in Hong Kong and Singapore.

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[2] FINAL_TCFD_ROADMAP.pdf (publishing.service.gov.uk)

[3] "Public Input Welcomed on Climate Change Disclosures," Acting Chair Alison Herren Lee, March 28, 2021, https://www.sec.gov/news/public-statement/lee-climate-change-disclosures.

[4] Prepared Remarks Before the Principles for Responsible Investment "Climate and Global Financial Markets" Webinar, July 28, 2021, https://www.sec.gov/news/speech/gensler-pri-2021-07-28

[5] *Id.*

[6] Executive Order on Climate-Related Financial Risk, May 20, 2021, https://www.whitehouse.gov/briefing-room/presidential-actions/2021/05/20/executive-order-on-climate-related-financial-risk/.

Financial institutions are very aware of this explosion of new requirements, and of the challenge they face in continuously adapting to rapid change. Participants in the roundtables supported the focus on climate change considerations and allocation of capital to low carbon, transitioning or enabling businesses and many see this as an urgent priority. Their concerns relate to transitional problems associated with this change: namely the range of initiatives across different markets, the accuracy and availability of data, the lack of alignment of data supplied by analytics providers and the need to use proxy data where gaps exist. Many noted that as a process climate change reporting was more challenging and complex than had been anticipated. There is concern about disparities between the current pace of change around the world in relation to climate-related disclosure requirements and the data and reporting methodologies required to fulfil those requirements.

1.2 Comparable, reliable data

For meaningful reporting, financial institutions require access to reliable, comparable climate-related data that comes directly or indirectly from the underlying organisations who are their counterparties or in which they have invested.

This is not currently generally available. Reporting methodologies, obligations, disclosures and data capture across all sectors are currently immature around the world. This is an even greater challenge where the counterparty or investee is not subject to equivalent reporting obligations, for example because it is located outside the UK or the EU or is a small or medium sized enterprise with no equivalent reporting obligations.

In the absence of other sources, reporting of financed emissions by financial institutions will necessarily be based therefore on aggregated information developed in an inconsistent way. The underlying components will come from data providers (both reporting companies and analytics firms) who have collected and reported it pursuant to different methodologies, different interpretations of the same methodologies, or using different assumptions. There may also be data gaps that are filled using proxy data, such as sectoral averages, again developed in different ways. Institutions anticipate that reporting will be useful in directional terms immediately, but that it is unlikely to be correct in its detail for the initial few years, pending development and roll-out of internationally accepted methodologies.

In addition, more information is becoming available from sources outside the corporate groups to whom the information relates. Information increasingly may come from satellite and digital technologies. With changes in GHG information sources and quality, there is a need for clarity that, as regards their own reporting obligations, financial institutions should be permitted to accept as accurate the information disclosed in a company's regulatory reporting. This would align with the approach proposed by the European Banking Authority for reporting under Article 8 of the EU Taxonomy Regulation.

Section 3 explores how these issues can be reflected in climate-related disclosures to contextualise the climate disclosures provided.

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1.3 Information from data analytics providers

Participants in the DWG roundtables expressed particular concerns about data from data services companies. They perceive that data services often do not provide sufficient information on how their data and reports are sourced, curated and verified.

Some described these products as "black boxes" and others were concerned that information products are sold without the provider taking appropriate levels of responsibility for the information. Institutions concurred that the terms provided by data vendors tend not to be customer friendly and there is a perception that some data vendors are not yet willing to stand by the quality of the data they are providing.

Gaps in coverage and lack of correlation in findings are still real problems. One participant reported approaching a number of data providers but still only receiving data that covered 75% of their assets under management. Another participant gave the example of having compared emissions estimates across providers. In respect of about 70% of the data providers approached, there was a variance between different providers' scope 1 and 2 emissions data of around 10% (which was considered a large variance by the participant). With scope 3 data, however, the variance between providers was so large that it reduced the relationship to a mere directional correlation. There has been a general realisation also that many proxy advisers and other data providers need to increase their capacity to assess the quality of company information and of transition plans to support robust and meaningful shareholder engagement and voting.

This is therefore an area where the services provided will need to evolve to provide something that is more "fit for purpose" in quality, coverage and terms of provision. This may result from regulatory standard setting, or over time from improved inputs and greater competition.

1.4 Materiality

Materiality is both relevant to and challenging to assess as regards climate-related disclosures because of the long-tail and potentially fat-tail nature of these risks and the dependency of outcomes on many external factors. Some participants in the roundtables were concerned about how directors would engage with climate change information and consideration of materiality in that context. Given the lack of precision relative to traditional financial information and more familiar materiality judgements, they anticipate some discomfort.

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In relation to financial reporting, the International Accounting Standards Board ("**IASB**") defines information as material "if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity".[7]

In a UK corporate reporting context, materiality is generally judged based on the size of the business or risk relative to the group of companies taken as a whole. A matter may also be sufficiently material for inclusion having regard to the purposes of the annual report. These include enabling an understanding of the development and performance of the business for existing and in some cases potential shareholders.

[7] IFRS - Amendment issued: IASB clarifies its definition of 'material'

The strategic report has the express purpose of helping shareholders assess how the directors have performed their duty to promote the success of the company. The annual report as a whole provides information needed by shareholders and investors to make resource allocation decisions (to buy, to sell, to hold) and for stewardship purposes (e.g. deciding how to vote on resolutions at annual general meetings such as the election of directors and executive remuneration).

What is material in a particular case is always a matter of judgement. It is not fixed, and the things that are determined to warrant disclosure may change depending on both internal and external circumstances. The board of a company that is required to make disclosure must therefore determine what is material based on what the "reasonable user" would consider to be material at the time the disclosure is provided. However, perceptions of climate-related disclosure that may be material to investors are likely to evolve quickly and in the short-term institutions may elect to make disclosure on a general, precautionary basis; boards should be conscious of the need to stay up-to-date with information relevant to their decisions and may wish to take soundings from their advisers on current practice and approaches.

Financial institutions already have obligations under Pillar III capital and disclosure requirements to identify and set out their approach to material risks and to ensure that their risk profile is comprehensive and adequately capitalised. Pillar III disclosures are used by investors and develop over time as techniques and risk management change. The increasing scrutiny of prudential and other financial regulatory authorities points towards a need to consider in a structured way whether and to what extent a regulated institution has, or may have, material climate-related financial risks that require disclosure, or the holding of additional regulatory capital, and how these risks are managed.[8]

Additionally, the traditional expression of materiality by reference to the actual or potential financial impact of the issue on the business of the reporting entity is in the process of being expanded in informal, commercial usage to reflect two additional pillars:

1.4.1 materiality in terms of the impact of the underlying activities of the investee or counterparty businesses on the environment; and

1.4.2 materiality in terms of contribution to financial system exposure to climate risk.

If disclosures are being made for a particular policy purpose and are required in order to be used in a particular way by investors (and this is expressed in regulatory communications and in consultations and draft regulation), this is likely to develop the nature of materiality. This evolution is emerging in the UK roll out of TCFD reporting, and in the EU, as regards impacts on the environment. It is implicit in recent TCFD consultation papers on metrics and targets. The shifting landscape makes it all the more important that reporting entities disclose clearly on this topic as discussed in section 3. Assessment of materiality is likely to evolve as market and regulatory understanding of, and government attitudes towards, climate change, fossil fuels, opportunities for new, green technologies and a "just transition" develop.

[8] Under CRR II (article 449a), banks will be required to disclose specific information in relation to ESG risks from June 2022 onwards

1.5 Scenario analysis

Many financial institutions have not yet made disclosure in respect of scenario analysis or have only disclosed analysis at a very high level or in respect of part of their business.

Various participants reported considerable difficulties in incorporating scenario analysis into public disclosures. Participants were familiar with scenario analysis, but most use it for the purposes of internal strategy or discussions with regulators and considered they were on a learning curve in relation to this area.

Some felt that publishing the conclusions from any analysis would be new ground. A number of firms queried the appropriateness of requiring analysis for climate that is much more sophisticated than other areas like Brexit, where there were more concrete data and certainties.

Many financial institutions have not yet made disclosure in respect of scenario analysis or have only disclosed analysis at a very high level or in respect of part of their business.

For asset managers, there was an expectation that scenario analysis of the type contemplated in TCFD might be challenging given the long(ish) timeframes for climate scenarios relative to those of investment strategies. Participants also noted that it is difficult to quantify impact given the extremely complex climate models.

Where firms are intending to make disclosure in their current report, they indicated this was likely to be high level, with an indication of directional sensitivities, much as they already do for interest rates and credit risk. If more detailed disclosure is required as a result of ongoing consultations, it seems likely that further capacity building will be required, and these disclosures will need to be framed as reflecting conceptual futures rather than projections.

1.6 Metrics

To date, disclosures have been largely narrative/qualitative in voluntary TCFD reporting.

The 2021 TCFD and FCA consultations both envisage the use of metrics in financial reporting which will substantially increase the quantitative reporting under TCFD. The view of participants generally was that metrics are necessary, indicative of direction of travel and will become more useful as experience develops. However, as matters stand, they currently also risk creating an impression of precision when they are most probably based on incomplete underlying data. Several participants noted that the requirement for metrics increases the risks to reporting entities arising from data inadequacies and that some methodologies for metrics are viable only for some asset classes and not others.

The 2021 TCFD and FCA consultations both envisage the use of metrics in financial reporting which will substantially increase the quantitative reporting under TCFD.

A consistent and realistic regulatory approach to this will be needed therefore during the transitional period and reporting firms will wish to take particular care in framing these sections of their reports as we discuss in section 3.

2 What are the risks and liabilities associated with reporting failures for financial institutions?[9]

2.1 Legal and regulatory liabilities in relation to annual reporting

As noted in the last CFRF Disclosure guidance,[10] a failure by a UK listed company to disclose a climate-related risk in its annual report could potentially involve a range of corporate liabilities under UK law, including:

2.1.1 criminal liability for breach of provisions of the UK Companies Act 2006[11] ("**CA2006**");

2.1.2 civil liability of its directors to the company for false or misleading statements (limited by s463 CA2006);

2.1.3 liability of the company to investors either under general principles of liability for misstatement (for example fraud or tort) or under statutory provisions; and

2.1.4 sanctions imposed by the FCA for listing rules breaches, transparency rules breaches or for market abuse.

In many cases, there may be multiple possible liabilities arising in relation to a single disclosure failure. In addition to company liability for disclosure issues, directors may be personally exposed to liability in relation to the preparation of reports and accounts. This personal liability can include criminal sanctions relating to the preparation of these documents under the CA2006 and, in the case of companies with publicly traded securities, under the FCA's rules. In practice, this is very rare in the UK, though it can be more common in some other markets (e.g. Germany and the US).

In many cases, there may be multiple possible liabilities arising in relation to a single disclosure failure.

In the UK, these possible heads of liability are each subject to specific provisions of company law and/or the Financial Services and Markets Act 2000 ("**FSMA**") as well as general principles of law. For example, the statutory liability regime under section 90A and Schedule 10A FSMA limits the extent of issuer and director liability in relation to information published by entities whose securities are admitted to trading on a securities market.[12]

Importantly, particularly over the coming period, any legal consequence, whether criminal, administrative or civil, will of course depend on the nature of the failing and the degree of culpability of those responsible. Another factor may be the location of the disclosure since the liability regimes that apply in part depend on what document it is included in (e.g. section 463 CA2006 only applies to directors' and strategic report so wouldn't on the face of it cover TCFD disclosures in other documents).

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9 It is worth bearing in mind that other liability regimes exist which may be applicable to ESG disclosures in other contexts. For example, s90 FSMA makes any person responsible for listing particulars or a prospectus liable to pay compensation to a person who acquires securities to which the particulars apply and who suffers loss either as a result of any untrue or misleading statement in the particulars, or due to an omission of information required to be included in the particulars (e.g. information that allows an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of the issuer of the securities).

10 Climate Financial Risk Forum Guide 2020 - Disclosures chapter (fca.org.uk)

11 Offences under the Companies Act 2006 will only apply to UK incorporated companies while the FCA/FSMA provisions will apply to UK-listed companies wherever incorporated

12 The statutory regime under FSMA contrasts with the position under the general law for the reports and accounts of unlisted companies, where a merely negligent statement or omission may give rise to liability to members who have suffered loss, with the purpose of the accounts disclosure generally being regarded as stewardship rather than to allow the reader to make an informed investment decision (although other responsibilities may be specifically assumed on a case by case basis).

This position is in the process of development. TCFD reporting requirements are proposed for FCA and PRA regulated firms, and their directors (in particular under the UK Senior Managers and Certification Regime ("**SMCR**")). They are therefore likely to be subject to a similar risk of liabilities and penalties under UK law and the PRA/FCA rulebooks (but would not benefit from section 463 CA2006). UK regulations are also proposed to require TCFD reporting by publicly quoted companies, large private companies and large limited liability partnerships ("**LLPs**").[13] These will apply the same regimes for TCFD reporting for compliance failures as currently apply to other reporting breaches relating to the strategic report.

2.2 Forward looking statements

The need to create a proportionate liability regime, especially in the context of forward-looking statements, has been recognised in other contexts by policy makers.

In the UK, the statutory liability regime under Schedule 10A FSMA (which applies to regulated information, including annual reports and accounts, published to investors via a Recognised Information Service) was introduced to reduce the likelihood of defensive and bland reporting and of speculative litigation.[14] It excludes liability of issuers or directors to any person except in cases of fraudulent or reckless omissions or misstatements, or dishonestly delayed publications, committed by a person discharging managerial responsibilities. Negligence is not sufficient to establish liability under Schedule 10A FSMA. This regime, however, does not preclude the imposition of regulatory sanctions (for example under the FCA's Listing Rules, e.g. for failure to satisfy the new TCFD reporting expectations) or the statutory restitution scheme under FSMA whereby the FCA may provide for investors to be compensated for losses. It also does not preclude civil or criminal penalties, liability under contract or where specific responsibility had been assumed for the accuracy of information.

In July 2021, HM Treasury launched a consultation on the UK Prospectus Regime which included a proposal to replace the current "negligence" standard for inaccurate forward-looking statements in prospectuses, with a higher standard that would require knowledge or recklessness in relation to an untrue or misleading statement, i.e. a standard similar to that used in the Schedule 10A FSMA regime. The proposed reduction in liability exposure would only apply to statements in prospectuses which project or predict a future state of affairs, which is likely to become of relevance in the context of climate disclosures.[15]

There are also detailed rules in the FCA Handbook and MiFID II that apply to regulated firms when presenting the past, future or simulated past/future performance of their products – which are underpinned by a general obligation on firms to be fair, clear and not misleading. A breach of these requirements can result in a range of penalties being imposed by the FCA including public censure, financial penalties and suspensions.

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[13] Mandatory climate-related financial disclosures by publicly quoted companies, large private companies and LLPs - GOV.UK (www.gov.uk)

[14] HM Treasury: Extension of the statutory regime for issuer liability (July 2008)

[15] Consultation on the UK prospectus regime (gov.uk) – see Chapter 1 for background and Chapter 5 for information on forward looking statements

2.3 UK litigation risk in respect of disclosure failures

Institutions are increasingly aware of and concerned about the potential for litigation in relation to their climate-related risk disclosures.

In this context, institutions are increasingly aware of and concerned about the potential for litigation in relation to their climate-related risk disclosures. While the liability risk associated with various disclosure routes is potentially quite different, generally, a disclosure failure will be one of four main types:

2.3.1 complete failure to disclose;

2.3.2 disclosure of untrue or misleading information;

2.3.3 disclosure with a material omission; and/or

2.3.4 delayed disclosure.

The nature and extent of liability will generally depend on whether the failure was deliberate or inadvertent, how material it was, who has suffered harm as a result, and when the loss was suffered relative to when the disclosure failure occurred, as well as the location of the disclosure.[16] There may or may not also be a requirement to prove reliance on the relevant disclosure (or omissions).

As an example, in summer 2021, the environmental NGO ClientEarth filed complaints with the FCA against a food delivery company and a travel company.[17] ClientEarth alleged failure to disclose climate risks to investors in breach of legal requirements under the Listing Rules and Disclosure Guidance and Transparency Rules to disclose material risks to investors. It claims that the disclosures either make no reference to climate change or provide only limited commentary on environmental impacts and risk, giving investors a potentially misleading impression of how resilient the companies are to climate change.

In addition, listed financial institutions, and a significant proportion of unlisted financial institutions, generally do not operate in or draw investors from a single country. This means that potential liabilities could also arise under the laws of other countries. Jurisdiction and applicable law are typically determined by the place where the damage is suffered (potentially the country where an investor read and relied on an alleged misleading statement), though the location of the issuer (or the credit institution, insurance company or asset management firm) will be relevant particularly in relation to any statutory liability. UK regimes may define expectations of UK mandated disclosures, and the disclosures of foreign companies in respect of securities traded on UK markets, [18] but they are not able to extend the protection of statutory safe harbours beyond the jurisdiction of the UK.

2.4 US litigation risks

A number of the firms who participated in the roundtables and the DWG have securities listed in the US and the UK, or market financial products in both countries. The US is a jurisdiction they are very aware of in relation to climate-related risk, though in fact

16 For example, FSMA s.90 applies only to prospectuses and listing particulars which are issued prior to listing.

17 ClientEarth files complaints against Just Eat and Carnival over climate failings | ClientEarth

18 E.g. FSMA Schedule 10A Section 1(1)(a).

there has been relatively little successful litigation to date in relation to climate-related disclosures in the US.

Public companies may be liable under US federal securities law for disclosures if the disclosure includes a materially false or misleading statement or if the disclosure omitted material facts. Shareholders asserting a securities fraud lawsuit would have to prove an intent to deceive, causation between the alleged misrepresentation or omission and the purchase or sale of a security, economic loss, and a causal connection between the plaintiff's reliance and economic loss. Each US state also enforces state securities laws which contain substantially similar provisions to the federal securities laws.

In the US, CEOs and CFOs are exposed to liability as the individuals who "control"' the company and are held responsible for any materially false or misleading statements. Directors of a public company could also be subject to liability based on such disclosure reflecting any disregard of the board's oversight responsibilities.

Climate change disclosures can also give rise to litigation under state law consumer protection and anti-fraud statutes, and state common law tort claims, as well as state and federal government investigations as can be seen from the investigations into Exxon. The recent trend of civil suits relating to climate change and human rights disclosures and impacts continued unabated through 2020 and into 2021, though the US Supreme Court cases recently ruled against the plaintiff on technical grounds in a climate change lawsuit brought by a city government. The Supreme Court has not yet ruled on the merits of any climate change theories of liability asserted in this recent wave of lawsuits, although at least one intermediate appellate court has indicated that climate change is an issue best addressed by the legislature and executive, congruent with the Supreme Court's decision in 2011 that state governments cannot seek climate damages under federal common law due to the federal Environmental Protection Agency's authority to regulate greenhouse gases.

The recent trend of civil suits relating to climate change and human rights disclosures and impacts continued unabated through 2020 and into 2021.

In a sign that the Biden administration's focus on climate and ESG issues will likely translate into increased enforcement and litigation risk, the SEC on 4 March 2021 announced the launch of a Climate and ESG Task Force. This will principally focus on identifying "material gaps or misstatements in issuers' disclosures of climate risks under existing rules", analysing "disclosure and compliance issues related to investment advisers' and funds' ESG strategies", and evaluating "tips, referrals, and whistle-blower complaints on ESG-related issues".[19] Additionally, the SEC's Division of Examinations in its 2021 Examination Priorities Report indicated that it will "prioritize emerging risks, including those relating to climate and ESG",[20] and on 9 April 2021 issued a Risk Alert highlighting "instances of potentially misleading statements regarding ESG investing processes and representations regarding the adherence to global ESG frameworks".[21]

[19] SEC Announces Enforcement Task Force Focused on Climate and ESG Issues, March 4, 2021, https://www.sec.gov/news/press-release/2021-42.

[20] Press Release, SEC Division of Examinations Announces 2021 Examination Priorities, March 3, 2021, https://www.sec.gov/news/press-release/2021-39. Report available at https://www.sec.gov/files/2021-exam-priorities.pdf.

[21] Risk Alert, The Division of Examination's Review of ESG Investing, April 9, 2021, https://www.sec.gov/files/esg-risk-alert.pdf.

However, in the US, a forward-looking statement accompanied by sufficient cautionary language is typically not actionable as the basis of a private suit brought by investors because a reasonable investor could not have found the statement to be materially misleading. SEC Commissioner Elad Roisman has suggested that any SEC rules mandating climate and ESG disclosures should include a safe harbour for such disclosures in line with that afforded to forward-looking statements.[22]

3 Managing risks in reporting and good practice approaches

To manage the litigation and enforcement issues discussed in section 2, financial institutions are likely to want to include framing wording in their reporting to represent any challenges and limitations they have encountered in relation to obtaining and analysing climate-related data. This is to minimise the risks of investor reliance on incomplete or imperfect information. Of course, institutions may also wish to engage with policy makers and regulators across key markets to seek protections during this transition phase where they have made disclosure on a reasonable and diligent basis. This section reflects approaches to managing the current issues with disclosure discussed with participants at the roundtables.

3.1 Form of report

The general view of financial institutions who are reporting under incoming TCFD UK regimes is that inclusion of TCFD disclosures within the strategic report alone is not desirable. This is because of the technical content required for TCFD reporting and the fact it cannot be articulated very concisely.

Institutions are generally proposing to provide their TCFD reporting as a supplement to their annual report when reporting under the Listing Rules. A small summary would feature in the annual report itself with a link to the supplement for more information. Given the need for precision and a robust section outlining assumptions, data issues and methodology, this seems a prudent approach. The TCFD reporting supplement is likely also to be the location for climate change emission reduction targets commitments and discussion of transition plans.

3.2 Precise, accurate and verified qualitative and qualitative disclosures

These disclosures may be subject to scrutiny from a wider range of stakeholders than many others in an annual report. ESG as a topic is one where any perceived difference between reality and disclosures risks generating a strong reaction from external and internal stakeholders if there is any suggestion of overstatement, a lack of balance or "greenwashing". While this has been an ongoing issue, it is receiving greater prominence in 2021 and allegations of greenwashing in corporate reports or in relation to a particular product or business are proving potentially very damaging for any organisation.[23]

ESG as a topic is one where any perceived difference between reality and disclosures risks generating a strong reaction from external and internal stakeholders.

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[22] Speech, "Elad Roisman: Putting the Electric Cart before the Horse: Addressing Inevitable Costs of a New ESG Disclosure Regime," June 3, 2021, https://www.sec.gov/news/speech/roisman-esg-2021-06-03.

[23] Deka fights lawsuit on misleading positioning of its impact equity fund (citywireselector.com); DWS probes spark fears of greenwashing claims across investment industry (ft.com); Santos sued for 'clean fuel' claims and net zero by 2040 target despite plans for fossil fuel expansion (Guardian); and ClientEarth files complaints against Just Eat and Carnival over climate failings (ClientEarth)

Disclosures should therefore be written in a way that is clear to the layperson and should be tested for clarity, caveated where necessary, and above all verified. Where technical or market terms are used, these should be explained in plain English. If different approaches are taken to different business areas or product types or if a risk assessment or screening process has been applied to only a proportion of the business, this should be transparent. This is an area for real care, precisely because of its novelty and complexity and the judgements that will need to be made and because historically it has been one which has sometimes been the subject of less rigorous scrutiny.

3.3 Methodology

Transparency as to the type of challenges institutions have encountered in obtaining and aggregating climate data from their borrowers, investors, counterparties and data analytics firms is likely to be an important part of any disclosure.

Clear information on these challenges can help manage expectations of and reliance on the data and metrics provided and limit the reporting entity's litigation risk. It is important to find a wording that provides a factual account of these issues without giving the impression that the reporting entity is generally disclaiming responsibility for reporting or for considering and addressing its strategy and exposure to climate-related opportunities and risks.

Institutions are likely to wish to create a detailed internal methodology record and to make disclosure of the key issues in more general terms in any TCFD report, including:

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3.3.1 from where and how data has been collected;

3.3.2 definitions used, including frameworks, taxonomies and methodologies used, including as applied to each broad group of products or services;

3.3.3 relative completeness of data, by reference to geography and sector, and nature of the financial institution's business or product/service line through which it derives;

3.3.4 lack of consistency in data provided from different sources; where data is obtained from data analytics firms, information on their methodology and terms of provision. Where methodology is not disclosed in detail to the reporting entity this should be stated;

3.3.5 internal governance, including verification process and methodology, resourcing and competencies, and ensuring an adequate budget for the task;

3.3.6 assumptions and key judgments or interpretations made in the aggregation, measurement and reporting of climate change risk and its impact on institution strategy;

3.3.7 where there has been proxy data used or extrapolation from a smaller data set, information about the approach and how the institution has scaled up or reached conclusions and tested their robustness; and

3.3.8 forward looking factors which the institution has decided to apply in its analysis such as pace and nature of regulatory policy, liability risks, market development, and macro geo-political factors, including anticipated or emerging physical and social impacts of climate change.

Institutions may also wish to consider borrowing from the "**as far as they are able**" concept developed in the UK Department of Work & Pensions ("**DWP**") regulations and guidance for pension fund TCFD reporting. This recognises that there may be gaps in the data that reporting entities are able to obtain for these purposes and that challenges may exist in relation to the quantification of climate risks for certain financial products, or, for defined benefit schemes, in relation to scenario analysis. The "as far as they are able" concept means taking all such steps as are reasonable and proportionate in the particular circumstances, taking into account the costs (or likely costs) which will be incurred by the scheme and the time required to be spent by trustees, and providing justification of the approach taken. Reliance on this concept is strengthened where the reporter keeps a clear record of its approach, its efforts, its interpretations and any cost-benefit analysis.

In considering how to approach these issues, a range of sources are available that articulate good practice, including DWP statutory guidance and Pensions Regulator climate change governance guidance, FCA consultations and policy statements, FRC communications and the publications of the TCFD itself. In addition, institutions may also wish to look at (i) guidance set out for other reporting regimes including the EU Taxonomy Regulation and (ii) the approach of other multinationals including those in the extractive sector who have prepared public summaries of their methodology for GHG reporting.

3.4 Metrics

Metrics are clearly an important part of reporting. However, they can give a false impression of precision or completeness of data currently available to financial institutions. This can be addressed by a short statement noting the data issues underlying the disclosure and warning that these metrics offer a directional indication only, or linkage to wording on methodology and an explanation as to the appropriateness of particular methodologies for some asset classes and less for others.

3.5 Disclaimers

Financial institutions are considering carefully how disclaimer language may be included in TCFD reporting and other climate and ESG disclosures to address the data gaps and uncertainties that this reporting currently involves.

Financial institutions are considering carefully how disclaimer language may be included in TCFD reporting and other ESG disclosures to address the data gaps and uncertainties that this reporting currently involves.

Any disclaimer should accurately reflect the area of concern and should be tested to ensure it is neither too narrow nor too wide. The location, font size and formatting of the disclaimer should also be considered carefully, so it is not presented in the form of "legal boilerplate".

The disclaimer should be reviewed in the context of the disclosure as a whole: information as to methodology or metrics may be an effective part of limiting the risk of stakeholders misunderstanding the information or relying on information without a clear appreciation of its purpose, gaps and limitations.

In the recent Shell case,[24] the Dutch court interpreted some broad disclaimers and other statements in Shell's climate strategy documents as undermining its commitment

[24] ECLI:NL:RBDHA:2021:5339, Rechtbank Den Haag, C/09/571932 / HA ZA 19-379 (engelse versie) (rechtspraak.nl)

to the targets stated. Though this decision is under appeal at the time of publication, it is worth considering whether any disclaimer is at risk of similar criticism and whether this creates risk for the institution and to adjust or contextualise to mitigate this concern.

3.6 Materiality

Many institutions are considering the extent to which their disclosures should address different concepts of materiality - i.e. not merely financial impact on the company itself, but also the impact of the institution's activities on the climate or as a component of wider systemic risk posed to the financial markets by climate change.

The prevailing view amongst participants was that the focus of the portfolio alignment framework within the TCFD at present is on materiality (financial performance). Given the different approaches at EU level, where double materiality is contemplated with disclosure also required in respect of impacts on the environment, and the informal use of metrics as indicators relating to the wider financial system, this is an area which may require further communication in UK policy statements, regulation and guidance.

In the meantime, any assessment of materiality should be made and recorded carefully, with a particular focus on clear communication of the meaning of materiality in the context it is deployed.

3.7 Governance

Disclosure in relation to climate change is new and potentially challenging for board members. Some institutions have allocated TCFD reporting to the subcommittee with wider disclosure responsibilities. There was an acknowledgment that board members should be provided sufficient time and opportunities to engage with the subject matter; and an expectation that boards may initially rely to an extent upon the executive team putting together the disclosure, given its technical nature.

> Disclosure in relation to climate change is new and potentially challenging for board members.

However, directors' duties are broad enough to require consideration of any material factors that arise during a director's tenure: for the foreseeable future this will include climate change and ESG issues. Additionally, under the UK SMCR rules, Senior Managers are required to take reasonable steps to ensure that the business of the firm for which they are responsible, is controlled effectively and complies with the relevant requirements and standards of the UK regulatory system. In the same way as for other relatively new risks, for example cyber and data privacy, the Board (in relation to the business as a whole) and Senior Managers (in relation to the business or function they oversee) should take relevant climate factors into account when making decisions, including in relation to strategy, risk management, investment and disclosure. To perform their duties, they require a reasonable awareness of climate change and other ESG developments material to the institution's business and will need to keep this up to date. Executive directors and non-executive directors with expertise (and senior managers with the relevant responsibility) in areas relating to sustainability, ESG or energy, law or accounting or audit requirements can expect to be held to a higher standard on these topics.

Areas to keep under review include the frequency with which the Board and the relevant subcommittees consider climate change and related disclosure, the subject-matter command of both Board and executive team (in particular Senior Managers), and the need for upskilling, and integration of salient climate factors into the decision-making processes of each business line and function.

The FRC has previously noted in relation to voluntary TCFD disclosures that there are areas where improvements to current reporting are desirable.[25] These should be an area of consideration for boards reviewing disclosure and they may well bleed into regulatory expectations as disclosure regimes continue to tighten. They include:

3.7.1 Greater clarity as to how governance frameworks in relation to climate change have translated into decisions on strategy, including examples of key decisions informed by consideration of climate risks.

3.7.2 Where the company has set sustainability targets or goals, it should report on progress towards these goals, and specifically how this will be achieved, monitored and assured. This is likely also to be captured in the new TCFD guidance on metrics and targets.

3.7.3 Where financial risks and opportunities are identified in company reports, the financial implications are often still unclear from the disclosure. Companies and their auditors should be working to improve this.

3.8 Accounting and auditing Issues

The information generated through any TCFD process is potentially of relevance to the auditors of a company, as they review its financial statements. The FCA referred in its 2020 consultation paper[26] to an article published in 2019 by members of the IFRS which explains that issuers applying IFRS when preparing their annual financial report and accounts should consider:

3.8.1 whether investors could reasonably expect that emerging risks, including climate-related risks, could affect the amounts and disclosures reported in the financial statements; and

3.8.2 what information about the effect of emerging risks, including climate-related risks, on the assumptions made in preparing the financial statements is material and therefore should be disclosed.

Consideration of climate-related financial risks and how these are assessed and disclosed will be a focus in audit

[25] FRC Climate Thematic: Governance - How are boards taking account of climate-related challenges (frc.org.uk)

[26] CP20/3: Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations (fca.org.uk)

processes from 2021 onwards.

In November 2020 the IFRS published a note that confirms that companies must consider climate-related matters in applying IFRS standards when the effect of these matters is material in the context of the financial statements as a whole and which provides commentary on illustrative examples[27]. The FRC has also noted in its Climate Thematic Review[28] that audit firms are still developing their approach in relation to climate-related reporting. The FRC has indicated that auditors need to improve their consideration of climate-related risks when planning and undertaking audits and should do more to challenge reporting companies' assessments of the financial impacts of climate change. A group of European investors and an environmental NGO wrote in 2020 to audit firms to remind them of the need to consider climate change issues in the audit process.

Consideration of climate-related financial risks and how these are assessed and disclosed will be a focus in audit processes from 2021 onwards. It is best practice and it makes good sense to ensure that auditors are made aware of the TCFD processes being followed and the outputs and proposed disclosures arising from them. The process for this should be built into the disclosure project at a relatively early stage, to allow time for discussion and careful consideration of accounting issues.

This is an area that is likely to develop. The FRC has said it will conduct a survey of investors and others to understand their needs on audit and assurance and it will consider ESG-related amendments within future revisions of the auditing and assurance standards.

3.9 Assurance

Some institutions anticipate using third party assurance, but there was a general view that assurance is not substantively as useful in this phase of reporting as it is likely to become. There is recognition that assurers are in the process of upskilling and that the lack of an accepted methodology is a barrier as there is nothing detailed to assure against.

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The FRC has said[29] that it is especially important to be clear about what is assured and what level of assurance is provided. A limited assurance opinion may well be insufficient to meet expectations. Although a reasonable assurance opinion provides a higher level of comfort that will better meet expectations, the current level of data maturity may not be sufficient to enable this to be provided. A number of firms have also pointed out that absent clear methodologies, the criteria against which this would be assessed are unclear.

Institutions acknowledge that directors may wish to see such assurance put in place and where this is the case the benefits and limitations of any such assurance will need to be explained. One area where assurance may be worth consideration, in addition to those where adequate data enables conventional verification, is in assuring that data gaps, methodologies, assumptions, judgements and estimations are accurately disclosed at a general level by reporting entities. Any use of assurance should be accurately described both to the board and in any reference in the annual report or TCFD supplement.

[27] IFRS: Effects of climate-related matters on financial statements (November 2020)
[28] FRC: Climate Thematic Review 2020
[29] FRC Statement of Intent on Environmental, Social and Governance challenges (July 2021)

4 Conclusion

The "UK Climate Financial Risk Forum: Climate Data & Metrics Report" that is published alongside this paper highlights the ambition of firms as they engage with how to effectively report on climate related risks to which regulated firms and financial markets are subject. It identifies different metrics for different use cases (financial risk to the reporting entity, systemic risk, and impacts on the climate or environment). In its provision of metrics across three categories (basic, advanced, stretch), by implication it also illustrates the range of reporting capabilities that are developing in the market at present, and the room for further growth.

The DWG has experienced the enthusiasm and engagement of firms to provide climate related financial disclosure. There is however concern that the underlying data to develop precise disclosure is not yet available to meet the expectations and legal consequences of mandatory disclosure. The DWG notes that metrics can give the reader a false sense of precision, and that this is a matter that reporting entities will need to address in using them in their reports, so that readers of annual reports do not assign a greater degree of certainty to the information they convey than is intended.

Current legal frameworks for reporting have evolved primarily to drive the disclosure of issues of financial significance to the business of the reporting entity (and we expect this is also true of accounting standards). We anticipate that the regulatory and accounting environment will have to adapt somewhat further to the particular properties of climate data as reporting practice develops, and as the complexities and sensitivities of climate data become clearer. During the ramp up of mandatory reporting, issues relating to access to and reliability of data are obvious areas for improvement. In the meantime, reporting entities will wish to manage risk associated with data by explaining the limitations of data they receive, data gaps and use of proxy data, issues with methodologies and areas or product lines for which current methodologies are inappropriate. This paper suggests some of the areas to consider and how they may be addressed in disclosures. As a more general matter, during this phase it will also be particularly important for the regulators and the regulated to communicate on areas of difficulty and in relation to expectations and best practice and for both to revisit their approaches and guidance regularly.

Annex

UK TCFD-related climate-related financial risk reporting

The UK has based its principal reporting requirements on the TCFD.[30]

The TCFD was established in 2015 by the OECD's Financial Stability Board after the Paris Agreement and has become the unofficial gold standard for reporting on climate change globally. The framework focuses on financial impacts and is divided into four key pillars (governance, strategy, risk management, and metrics and targets) and addresses both the risks and business opportunities arising from climate change. This far, it has required reporting organisations to provide information on scope 1 and scope 2 greenhouse gas emissions.

The TCFD consulted in June and July 2021 on new guidance which expands its recommendations on metrics, targets and transition plans and published its final form guidance in Autumn 2021.[31] The new metrics include disclosure of material scope 3 emissions (where these account for 40% or more of total emissions), any internal carbon price applied, executive remuneration, and reporting on assets exposed to physical or transition risk, or opportunities, and climate-related expenditure. The guidance also suggests metrics applicable to financed or portfolio emissions, though the challenges inherent in data availability and aggregation are acknowledged, and reporting as to portfolio alignment of investment strategies to the Paris Agreement is also included, with flexibility as to how this is addressed. The FCA has indicated that UK guidance is likely to be updated to adopt any TCFD changes made in this process.

The principal climate-related reporting requirements under UK law, regulation and rules likely to affect UK-based financial institutions are set out below. These have been developed by several different law and policy-making bodies. While each leverages the TCFD recommendations, there are differences in approach. These variations add complexity and a clear roadmap highlighting and justifying differences by sector may assist reporting entities.

1 Premium listed companies

Under an FCA Policy Statement PS 20/17 dated 21 December 2020,[32] applicable for reporting periods commencing 1 January 2021, the Listing Rules have been amended to require premium listed companies to include a statement in their annual financial report in respect of their compliance with the TCFD reporting methodology on a comply or explain basis.

1.1 Under the FCA Policy Statement, premium issuers must set out in their annual report:

1.1.1 whether they have made TCFD recommended disclosures in their annual report and if so where;

1.1.2 if not, a description of which disclosures have been omitted, why and what steps they are taking to make disclosures consistent with the Policy Statement, including timing for this; and

[30] Task Force on Climate-Related Financial Disclosures | TCFD) (fsb-tcfd.org)

[31] Publications | Task Force on Climate-Related Financial Disclosures (fsb-tcfd.org)

[32] PS20/17: Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations (fca.org.uk)

1.1.3 where disclosures are set out elsewhere, an explanation of where and why the company has adopted this approach.

1.2 Although the obligation is a "comply or explain" requirement, the FCA guidance says it expects reporting companies to be able to make disclosures consistent with:

1.2.1 the TCFD's recommendations on governance and risk management set out below:

TCFD Recommendations and Supporting Recommended Disclosures

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

Source: Final Report, Recommendations of the Taskforce on Climate-related Financial Disclosures, June 2017.

1.2.2 TCFD recommended disclosures (a) and (b) under the strategy recommendation to the extent the listed company does not face transitional challenges in obtaining relevant data or embedding relevant modelling or analytical capabilities.

Strategy disclosures under (c) scenario analysis are not currently included in this list and so can more readily fall under the "explain" limb. Listed companies are required to be transparent about planned future enhancements to disclosures.

1.3 The FCA Policy Statement includes guidance that a company's determination of its level of consistency with TCFD recommendations should be reached through detailed work and analysis. In particular, it should include:

1.3.1 a detailed assessment of its proposed disclosures taking account of certain TCFD published guidance materials (which includes specific guidance focused on financial institutions);

1.3.2 consideration whether the disclosures provide sufficient detail to enable the reader to assess the listed company's exposure to and approach to addressing climate-related issues; and

1.3.3 Considering what is the appropriate level of detail for its climate-related financial disclosure, taking account of its level of exposure to climate-related risks and opportunities and the scope and objectives of its climate strategy.

Since the Policy Statement was published, the TCFD has published further guidance relating to metrics, targets and transition plans (discussed above). The FCA has indicated it expects to follow the final form recommendations of the TCFD on this, though the timing of any update is not known at the time of writing.

2 Further FCA TCFD consultations

The FCA has published further proposals for TCFD-based reporting in two consultations that closed on 10 September 2021.[33] These consultations relate to:

2.1.1 **Standard listings**. The extension of the Listing Rule on TCFD aligned reporting applicable to premium listed companies to those with a standard listing applies substantially the same guidance and expectations. This consultation also includes consideration of other ESG issues in capital markets, including green and sustainable debt markets and the role of ESG data and rating providers. The intention is for the new rule to take effect for financial years beginning on or after 1 January 2022.

2.1.2 **Asset owners / managers**. This consultation proposes introduction of TCFD aligned disclosure requirements for asset managers, life insurers and FCA-regulated pension providers at entity level on their websites. It also proposes certain product-related disclosures.

The intention is for these requirements to come into force on 1 January 2022 for large UK asset managers (i.e. enhanced SMCR firms that have AUM of more than £50 billion) and large asset owners (i.e. FCA regulated life insurers and pension providers that have £25 billion or more assets under management/administration). The requirements would apply from 1 January 2023 for other asset managers/owners, unless they have assets under management/administration of less than £5 billion (in which case they are exempted from the regime).

The requirement includes the production of an entity level report signed by a member of senior management that is consistent with TCFD recommendations, **including** scenario analysis and metrics and targets. If the entity has no net zero target the reason for this should be explained.

At product level, the consultation proposes mandatory metrics, including scope 1 and scope 2, and, by June 2024, scope 3 emissions and weighted average

[33] CP21/18: Enhancing climate-related disclosures by standard listed companies | FCA; CP21/17: Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers | FCA

carbon intensity (WACI). Best efforts metrics proposed include climate value-at-risk and any metric showing the climate warming scenario with which the investment is aligned. Delegated mandates and external appointments are also in scope of reporting.

3 BEIS consultation

The Department for Business, Energy & Industrial Strategy ("**BEIS**") consulted in Spring 2021 on TCFD-aligned reporting proposals for publicly quoted companies, large private companies and large LLPs.[34] The regulations are envisaged to apply to affected entities in respect of reporting periods starting on or after 6 April 2022.

Disclosure in respect of matters falling within the four pillars of TCFD is proposed to be mandated but scenario analysis is to be encouraged not required. Disclosure in accordance with all 11 TCFD recommendations appears not to be proposed, though disclosure across the four pillars is required. The consultation envisages non-disclosure where the matter can be justified as not material.

The same enforcement regime will apply as for any existing non-financial information statement in a company's strategic report. Auditors' responsibilities will be unchanged but are sufficiently broad to capture climate-related financial liabilities and impairments.

4 DWP reporting requirements

New regulations will apply from 1 October 2021 to impose requirements for occupational pension schemes to align their governance processes and disclosures with TCFD recommendations. Statutory guidance has been published containing the detail underpinning the new regime and where trustees deviate from the approach set out in the guidance, they are expected to describe their reasons for doing so in their TCFD report. The Pensions Regulator has also produced draft guidance on the governance and reporting of climate-related risks and opportunities.

The requirements apply in respect of seven areas: governance, strategy, scenario analysis, risk management, metrics, the selection of a target in relation to at least one selected metric, and as to trustee knowledge and understanding. Trustees must carry out scenario analysis, obtain GHG emissions data and other information relevant to their chosen metrics, use the data calculated and use those metrics to assess climate-related risks and opportunities and measure scheme performance against the trustee-set target "**as far as they are able**".

The regulations say that this means taking all such steps as are reasonable and proportionate in the particular circumstances, taking into account the costs (or likely costs) which will be incurred by the scheme and the time required to be spent by the trustees. This concept, which we have suggested drawing on for the purposes of other TCFD reporting, recognises that there may be gaps in the data trustees are able to obtain for these purposes of compliance. The statutory guidance also recognises that there are challenges in the quantification of climate risks with regard to particular investment products (for example, some sovereign bonds, contracts of insurance, asset backed structures and derivatives). The statutory guidance includes further

[34] Mandatory climate-related financial disclosures by publicly quoted companies, large private companies and LLPs (www.gov.uk)

details. The Regulator has said in its guidance that, where there are data gaps, it expects trustees to explain what efforts they have made to obtain the data, and to explain fully any gaps. The Regulator also says that trustees should outline their plans for overcoming those obstacles, as the quantity and quality of the data available is expected to improve over time.

This regime will apply in a staged way to:

4.1.1 Schemes with £5 billion or more in assets at the end of their first scheme year to end on or after 1 March 2020 and authorised master trusts who will be subject to the governance requirements from 1 October 2021.

4.1.2 Schemes with £1 billion or more in assets at the end of their first scheme year to end on or after 1 March 2021 who will be subject to the governance requirements from 1 October 2022.

Schemes will be required to publish their TCFD report on a publicly available website, accessible free of charge. The chair of trustees must sign the report. The TCFD report must be referenced in (but need not be included in) the Annual Report and Accounts and the Regulator must be sent a link to the scheme's TCFD report in its annual return.

5 Net zero commitments and climate transition plans

A growing number of financial institutions and companies are setting goals to achieve net zero emissions in their business and business relationships and developing climate transition plans to map out how they will change their strategy to achieve this. Many companies are using international methodologies, such as the Science Based Targets initiative[35] for developing their commitments and related plans.

These plans specify at a high level what intermediate actions and emissions reductions targets they will apply along the way. Any targets or transition plan reporting may need to be combined and will certainly require alignment with the institution's TCFD reporting. Companies should spend time on developing a credible, robust and achievable plan before they contemplate reporting on it or putting it to a shareholder vote. In particular, it is important to focus on the need to update on progress, including how to manage and communicate any implementation challenges and non-linear progression of emission reductions.

For carbon intensive sectors, climate transition plans are becoming the subject of shareholder scrutiny. In a small number of cases, this has already resulted in the tabling of an advisory shareholder resolution on the company's transition plan, whether this is at the initiative of the company, or as a result of investor pressure. Typically, companies will commit to report back to shareholders regularly on performance against the plan and to put any material change in the plan to a non-binding shareholder vote. Thus far, this has involved a limited number of carbon-intensive and/or activist targeted listed companies (in the UK at least). The Investor Forum (whose members account for a third of the UK's FTSE all share market capitalisation) has called on the UK government to consult on the roll out of non-binding "say on climate" votes akin to the advisory "say on pay" votes held at shareholder meetings in the UK.[36]

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35 Science Based Targets

36 Thinking-Aloud-Say-on-climate.pdf (investorforum.org.uk)

Over the next five years, target setting or publication of a transition plan and related disclosures may well become a regulatory requirement in key markets, including the UK. It is notable that the DWP's TCFD reporting regime already envisages fund trustees setting a target in respect of one of their chosen metrics and reporting on this. The TCFD latest consultation also extends to targets and transition plans, and in the EU, taxonomy reporting requirements for non-financial EU public interest entities under Article 8 of the Taxonomy Regulation include production and disclosure of a five-year capital expenditure plan. It would make sense for institutions to prepare themselves now for disclosure to move in this direction.

Glossary

“AUM”	–	Assets under management
“BEIS”	–	Department for Business, Energy & Industrial Strategy
“CA2006”	–	Companies Act 2006
“CFRF”	–	Climate Financial Risk Forum
“COP26”	–	The 26th United Nations Climate Change Conference of Parties to be held in Glasgow, Scotland between 31 October and 12 November 2021 under the presidency of the United Kingdom
“CSRD”	–	Corporate Sustainable Disclosure Directive
“DWG”	–	Disclosures Working Group
“DWP”	–	Department for Work and Pensions
“ESG”	–	Environmental, social and governance
“FCA”	–	Financial Conduct Authority
“FRC”	–	Financial Reporting Council
“FSMA”	–	Financial Services and Markets Act 2000
“GHG”	–	Greenhouse gases
“IASB”	–	International Accounting Standards Board
“IFRS”	–	International Financial Reporting Standards
“LLPs”	–	limited liability partnerships
“NGO”	–	Non-governmental authority
“PRA”	–	Prudential Regulation Authority
“SEC”	–	US Securities and Exchange Commission
“SMCR”	–	Senior Managers and Certification Regime
“TCFD”	–	Task Force on Climate-Related Financial Disclosures
“WACI”	–	Weighted average carbon intensity