Date: 24 September 2020

Response to FCA Consultation Paper CP20/3** Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations

Background

- The Local Authority Pension Fund Forum was set up in 1991 and is a voluntary association of 81 local authority pension funds and six LGPS pool companies, based in the UK with combined assets of approximately £300 billion. It exists to promote the investment interests of the funds, and to maximise their influence as shareholders to promote high standards of corporate governance and corporate responsibility amongst the companies in which they invest.

Response

The Local Authority Pension Fund Forum (hereafter LAPFF or the Forum) welcomes the opportunity to respond to this important consultation. In this section we outline our overall position before addressing the consultation questions in the following section.

LAPFF has long recognised the imperative to address climate change as a systemic and long-term investment concern for our members. It poses material financial risks across all asset classes with the potential for loss of shareholder value. A number of studies have quantified the level of the potential loss of value. A LSE study, 'Climate Value at risk for global financial assets' states: 'We find that the expected 'climate value at risk' (climate VaR) of global financial assets today is 1.8% along a business-as-usual emissions path. Taking a representative estimate of global financial assets, this amounts to $2.5 trillion'.[1]

LAPFF considers companies should report on their approach to carbon management in the context of how they are factoring the relevance of climate change into their business strategy, including through the lens of a just transition to a low-carbon economy.

[1] Dietz, S et al 'Climate value at risk of global financial assets', 2016

The Forum's engagement strategy is to ask companies to identify and tackle carbon risks in their business models and the concurrent opportunities. It also presses companies on aligning their business models with a 1.5°C scenario.

Achieving a just transition to a net zero economy cannot be achieved by companies or investors alone. It also requires government action to raise standards across the piece. With the provision of a clearly identified legislative framework on carbon reductions, companies will be able to make the necessary decisions and financial commitments to provide the short and long-term solutions to decarbonising the economy that are needed.

The Forum therefore strongly supports the introduction of mandatory carbon emissions and risk reporting.

LAPFF supports the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures report and considers all market participants should be encouraged to aim for the fullest relevant implementation. The Forum has long promoted mandatory climate risk reporting, the mechanism for which is already in place under the Companies Act requirements for companies to report financially material risks in the annual report. LAPFF also considers that in positioning themselves for the required low carbon future, companies should disclose a transition plan.

The Forum believes that the proposed rule as outlined in the consultation document is therefore to be welcomed. Greater disclosure would help investors fulfil their stewardship duties and also enable more informed decisions about capital allocation.

LAPFF does have some concerns about the in effect voluntary nature of the rule. The Forum understands the challenges that companies face in being TCFD compliant, many of which are outlined in the consultation document. However, the potential scale of the value at risk and urgency of the climate emergency demand a mandatory approach.

The Forum would therefore suggest if the rule is to be brought in on a 'comply or explain' basis, that at the same point the FCA announce its intention to make the rule mandatory after a set date (e.g. in three years' time). This would provide a clear signal to the market. It would give all listed companies time to be compliant, but also ensure that the benefits and objectives clearly outlined in the consultation document are not limited to one segment of the market.

Detailed response

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?

In the UK, the standard listing is a different category to the premium listing, because that is the EU minimum standard required, whereas premium allows for additional UK requirements. The proper purpose of the Listing Rules is for the protection of investors, and enabling transparency on climate risk should apply to all listed UK companies. We consider the new rule should apply to all listed companies, both premium and standard listing.

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, they should be included. If premium listing is a signal to the market of higher standards then standards on climate change disclosure need to be equally applied regardless of the company structure, shareholder composition and where it is headquartered.

Q3: Do you agree with our approach? [to asset managers]

The FCA proposed new rule is to apply to asset managers and insurers with a premium listing in their capacity as issuers, rather than in their capacity as regulated firms. Enhancing climate-related disclosure by asset managers as FCA-regulated firms is to be clarified separately with firms currently 'encouraged' to make voluntary disclosure in line with TCFD guidance. LAPFF takes a firm stance that if climate-related financial disclosure is not yet to be made mandatory for managers' products and investment strategies, that a time-frame should be announced in which these disclosure would be mandatory. Again a three-year time frame would seem appropriate. Such disclosure is vital for investors to understand the materiality of climate risk in their portfolios, and is crucial in carrying out fiduciary duties to beneficiaries.

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?

The Forum supports the TCFD's approach. As the consultation notes there is general consensus and their recommendations offer a clear framework for financial disclosure on climate change. We therefore agree that your rule should reference the four recommendations and 11 supporting disclosures.

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?

Guidance should include reference to supporting documents where it helps bring clarity. However, consistency regarding disclosure is extremely important. The consultation document notes that there might not be consistency at the outset and the desire to provide space for innovation. A degree of prescription is required otherwise how are investors and stakeholders to know whether a company that claims to be TCFD compliant is actually so? We would expect the guidance to ensure that this is not possible. Furthermore, for disclosures to be useful for investors when understanding the climate change investment risks there has to be comparability on disclosures. We would expect the guidance to acknowledge this and, when updated, seek to further ensure comparability.

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?

Referencing of additional sources of information for guidance and interpretation would be welcomed to enable a fuller understanding of the financial disclosures required, and to ensure consistency and reliability in information disclosed.

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?

The Forum has consistently had problems with the 'comply or explain' basis of corporate governance rules. Rules tend to be mandatory – 'comply or else'. Having rules on a 'comply or explain' basis may quicken the pace that some companies move towards disclosure but others will continue not to comply. We consider it would have been useful for the cost-benefit analysis to have outlined this (see our response to Q18). This will mean the rule only partially addresses the concerns laid out in 2.32 on market integrity in the consultation document.

We would instead prefer to see the rule to be mandatory. As noted in the consultation document the potential benefits could be significant and therefore a mandatory rule would extend these benefits. We understand that this would not be straightforward and we know from our engagements with chairs and board members of listed companies there are specific challenges around measuring emissions, scenario analysis and target setting. However, we would consider these elements the most useful and meaningful aspects of disclosure.

If the rule is to be brought in on a 'comply or explain' basis the Forum considers that the FCA should announce at the same time its intention to make the rule mandatory after a set date (e.g. three years). This would give time to companies to be compliant but ensure that the rule and the benefits extend beyond one segment of listed companies market.

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?

We do not think such disclosures should be subject to a materiality assessments as we consider them material issues.

Q9: Do you agree that issuers should ordinarily be able to make the recommended disclosures under the "governance" and "risk management" recommendations?

Yes, there seems little reason why a company could not disclose the governance and management of climate risk.

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?

Explicit guidance may not be required. However, this should be reviewed if exceptional basis is consistently used as a reason for non-disclosure.

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

Yes. The Forum sees climate risk as a financially material matter so these climate-related financial disclosures should be included in the issuer's annual financial report. If they are not disclosed in the annual report, important financial risks could potentially be hidden from shareholders and other stakeholders.

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. However, as noted above, LAPFF considers that disclosure should be within the company's annual report. This should preferably be in the strategic report, or the chair or chief executive's statement, with sign-posting to other parts of the annual report as appropriate for more detail. We have seen examples of TCFD disclosure improving over time with some listed companies, with reporting being brought 'front and central' within the annual report from one year to the next. Signposting readers to other documents should only be where a much more granular detail might be helpful. We also consider there should be a minimum level of mandatory disclosure for companies wishing to list for the first time.

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.

Credibility of disclosure, especially around current emissions levels and scenarios, is essential. A very basic, nontechnical issue, that the Forum encounters is regarding Scope 3 and what types of emissions are included (for example where business travel is included but not the much larger emissions of the end user).

As we have seen from emissions scandals but also accounting malpractices, robust auditing and assurance is required to provide market actors with an accurate account of a company's position. As climate change is a material matter, the auditing and verification of the disclosed data is essential for the market to function and for asset owners and their managers to understand the risks and opportunities.

We do not believe that the cost of undertaking an independent audit should be seen as a barrier given the size of listed companies and the value at stake (with the costs of performing audits most probably highest for those companies with the largest climate risks).

There would need to be a properly functioning market for the provision of such audits, and for scenario analysis. Providing a signal to the market mandating TCFD compliance could support the development of the sector. The Forum would also expect to see that those providing those services are adequately regulated. The Forum has been vocal about its concerns about the auditing and accountancy industry and the regulation of the sector. High standards are required for investors to trust the numbers and to avoid sudden drops in value due to misreporting.

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?

No specific feedback at this point.

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?

The Forum does not share the some of the potential concerns outlined. Although there are difficulties they are not insurmountable.

For example, information may at times be hard to acquire, but it is essential to understanding current risks. On the complexity of the climate change, we do not consider complexity should be a reason for non-compliance. Public companies inhabit highly complex environments and have to cope with other technical issues (cyber security, for example). The financial implications of climate change mean that complexity should not be an excuse. As noted previously, providing a signal of mandatory compliance would help overcome the institutional challenges outlined but will require a regulatory environment to ensure high standards amongst third-party service providers.

Regarding legal liability around future risks and opportunities, the Forum would expect them to be viewed in the same way as business planning and targets. Investors understand that a forward looking statement about growth is not a matter of fact or legally binding commitment but sets out where the company expects to be headed (although clear statements saying as much should be included). For that statement to carry any weight it needs to be credible.

The same applies for emissions targets and scenario plans. These statements are goals and as such shareholders are aware that, in certain instances, they may not be met. Disclosure about how targets are to be met and assumptions being made about scenario plans enable investors to make their own judgements. Equally interim targets enable companies to demonstrate to investors that there is a genuine road-map for making progress in the thirty years to 2050. In practice, this enables monitoring of how much progress is being made and an assessment how seriously the company is taking the financial risks of climate change. We would only envisage problems if transparency was not forthcoming or if companies were intentionally misleading the market.

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?

There should be no delay. We agree this timeframe would be the soonest realistically to be expected and support its implementation.

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

We agree that the costs of these changes relative to the revenue and capitalisation of listed companies would be extremely small. We would emphasise that there is likely to be a number of benefits to the operation of the market. There are also likely to be much wider economic benefits by supporting the move to a net zero carbon economy. As such the benefits have the realistic potential to outweigh those costs.

We understand quantifying the benefits would be an extremely complex exercise with contested outcomes but the analysis could have been more insightful in one respect. It would have been useful if there was an impact assessment of how many companies are likely to be affected by the rule. How many would have started to comply without the rule and what are the expectations for TCFD compliance after the rule? The costs outlined in the cost benefit analysis (CBA) therefore do not provide an accurate picture unless we are to assume that all companies will comply.

Providing this information would also provide much needed detail about the expected outcomes. After all, most CBAs seek to understand the benefit-cost ratio but also the quantum of the benefits (or costs) which would require knowledge about the number of companies that would comply rather than explain. Such information would have also helped stakeholders assess when responding to the consultation and whether the ‘comply or explain’ approach was appropriate – a central question of the consultation.

More generally, as the concept of the inevitable policy response[2] gains currency, we consider it vital that a robust approach to climate reporting is implemented within the shortest time-frame.

The COVID pandemic has shown how swiftly companies have been able to respond when confronted by the imperative of extreme events and we consider the same action is possible to respond to climate risk and current and impending climatic-induced impacts.

Investors rely on the corporate disclosure required by regulatory frameworks and mandatory reporting standards to ensure they have appropriate, relevant and accurate financial disclosure for their investment decisions.

LAPFF therefore considers clear, mandatory climate-related financial disclosure requirements should be set out for listed issuers and implemented by the proposed date of January 2021.

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[2] https://www.unpri.org/inevitable-policy-response/what-is-the-inevitable-policy-response/4787.article