CLIFFORD
CHANCE

SUSTAINABILITY SNAPSHOT: UK FCA SIGNALS NEXT STEPS IN ITS STRATEGY ON CLIMATE CHANGE AND GREEN FINANCE

OCTOBER 2019

SUSTAINABILITY SNAPSHOT: UK FCA SIGNALS NEXT STEPS IN ITS STRATEGY ON CLIMATE CHANGE AND GREEN FINANCE

The UK financial services regulator has signalled the steps it intends to take over the next few months in order to meet its strategic objectives on climate change and green finance. In a Feedback Statement (the 'Feedback Statement') issued on 16 October 2019, four priority actions were outlined, based upon the FCA's engagement with various UK, EU and international initiatives in this rapidly evolving area, as well as responses to its 2018 Discussion Paper (the 'Discussion Paper').

FCA Priority Actions – building a foundation for future work on climate change and green finance

Climate change disclosures by issuers

Consultation Paper to be published in early 2020

- proposing new disclosure rules for certain issuers aligned with the TCFD's recommendations on a 'comply or explain' basis
- clarifying existing disclosure obligations relating to climate change risks

Integration of climate change risk by regulated financial services firms

- Publication of a Feedback Statement to the joint discussion paper with the Financial Reporting Council (FRC) on stewardship, indicating the continued supervisory and policy interest in this topic
- Finalising proposed rule changes requiring Independent Governance Committees (IGCs) to oversee and report on firms' environmental, social and governance (ESG) and stewardship policies, by the end of 2019
- Finalising proposed rule changes to facilitate investment in patient capital

Regulatory expectations around green financial products and services

The FCA will:

- challenge potential greenwashing, clarify expectations and take appropriate action to prevent consumers being misled
- carry out further policy analysis on greenwashing and issue guidance to address concerns
- engage with the proposals of the EU Sustainable Finance Action Plan, particularly around common standards and product disclosures

Collaboration with Government, other regulators and industry

Continued collaboration on:

- the Climate Financial Risk Forum
- the Fair and Effective Markets Review (FEMR) working group
- supporting the Green Finance Strategy through membership of the Government-led cross-regulator taskforce on disclosures
- the EU Sustainable Finance Action Plan

Key Actions – Our view

Issuer Disclosures

A key headline is the FCA's announcement of a consultation in early 2020 on new rules to require certain listed issuers to make climate-related disclosures aligned with the recommendations of the Task-force on Climate-related Financial Disclosure (TCFD). This announcement comes in the wake of recent UK Government and EU endorsements of the TCFD recommendations, and the expectation expressed in the UK Green Finance Strategy paper that all listed companies and large asset owners should disclose in line with them by 2022. This proposal builds on the conclusions from the Discussion Paper that, although existing FCA disclosure rules should be sufficient to ensure that issuers properly disclose any material climate-related risks, there is uncertainty as to how to determine the materiality of such risks and no consistent framework for disclosure. In addition to the 2020 consultation, the FCA intends to clarify existing disclosure requirements in the context of climate-related risks.

Task Force on Climate-related Financial Disclosures

The industry-led TCFD's Recommendations and Detailed Guidelines (the 'Recommendations'), published in June 2017, encourage companies to include climate-related information within their financial disclosures.

The Recommendations are principally aimed at ensuring investors, lenders and insurance underwriters have sufficient information about how climate change could affect their actual and proposed investments. However, the Task Force suggests that all companies with public equity or debt should adopt them, both in financial and non-financial sectors.

There are four key areas for disclosure:

- **Governance**: The role of management in assessing climate change risks and opportunities, and oversight by the board
- **Strategy**: Where material, a description of impacts of actual and potential risks/opportunities from climate change upon the business's strategy and financial planning over different time horizons and the resilience of the organisation's strategy based on different climate scenarios
- **Risk Management**: Description of the organisation's process for identifying and managing climate-related risks and how these relate to the organisation's overall risk management framework
- **Metrics and Targets**: Where material, disclosure of the organisation's Scope 1, Scope 2 and, if appropriate, Scope 3 greenhouse gas emissions, and related risks; and a description of the metrics used to identify risks and opportunities

More generally, TCFD-compliant disclosure is gaining traction in business (Mark Carney, Governor of the Bank of England, recently noted that four out of five of the top global 1100 companies already disclose in line with some of the Recommendations). Responses to the Discussion Paper were generally supportive of the adoption of TCFD-related disclosure, but expressed a need to make the disclosure requirements proportionate. This call has been heard by the FCA which is proposing a "comply or explain" approach, at least initially. UK quoted issuers will be familiar with this sort of approach, for example, in the context of statutory greenhouse gas reporting, or reporting against the UK Corporate Governance Code (which applies to all companies with a premium listing of equity securities). A further emphasis of the FCA will be to ensure TCFD-related disclosure is useful for decision-making by investors. TCFD-related disclosure can be challenging, particularly given its emphasis on forward-looking analysis and scenario planning. It will be essential for the FCA to adopt clear guidance on TCFD-compliant disclosure for issuers. The FCA also notes that it intends to monitor whether disclosure of other sustainability factors will be needed to support investor decision-making.

The FCA notes that its approach to TCFD-aligned issuer disclosure will also guide how it looks at disclosure obligations of other regulated financial services firms. Again, a key concern expressed by regulated firms was to ensure requirements are proportionate, so this broader read-across should be welcomed.

Stewardship and Governance

Emphasising the importance attached to improving corporate governance and stewardship, the FCA intends to build on existing work to ensure firms integrate climate change risk into their business, risk and investment decisions.

Stewardship and Governance: existing initiatives

- the FCA published a consultation paper in relation to implementation of parts of the revised Shareholder Rights Directive (SRD II) – among other things, the FCA proposed introducing new rules for asset owners and asset managers to promote better engagement between them and greater disclosure of information about their investment strategies (these rules have been incorporated into the FCA's Handbook).
- the FRC published a consultation paper setting out proposals for revising the UK Stewardship Code – among other things, the revised code makes explicit references to ESG factors and expects signatories to take them into account when fulfilling their stewardship responsibilities. On 24 October 2019, the FRC published the 2020 version of the UK Stewardship Code which takes effect on 1 January 2020.
- the FCA and FRC published a joint discussion paper – accompanying the other two consultation papers referred to above – which called for more strategic input on the best ways of encouraging the institutional investment community to engage more actively in stewardship of the assets in which they invest. On 24 October 2019, the FCA published Feedback Statement FS19/7, identifying several things it plans to do, working with industry, the FRC, Government and other regulators in order to assist in addressing some of the remaining barriers to effective stewardship and outlining further work.

Independent Governance Committees
The FCA refers to steps that are being taken to integrate climate change and other ESG risks in workplace personal pension schemes. On 15 April 2019, the FCA published a consultation paper, which proposed the introduction of new duties for Independent Governance Committees ('IGCs') including a new duty to report on their firm's policies on ESG issues, consumer concerns and stewardship, for the products that IGCs oversee. The Feedback Statement highlights that the FCA will publish its policy statement and final rules in relation to this in late 2019. The FCA further notes that the proposed new rules for IGCs will be an important addition to the governance of workplace personal pension schemes as they will provide a means for independent oversight of providers' stewardship arrangements.

Addressing "greenwashing" concerns
The concerns regarding 'greenwashing', i.e. the practice of promoting a product as having better environmental credentials than it actually does, and the challenges presented in addressing it are well known in the green finance space. The FCA has said it will challenge firms where it sees potential greenwashing and take action to prevent consumers being misled. It will be interesting to see the basis for such challenge given that there is no widely accepted definition of what is 'green' and in many cases the determination of what constitutes greenwashing is subjective.

The FCA recognises that this area is complex and that further policy work will be needed to develop guidance in this area. No specific details are given to indicate what this guidance might cover, although reference is made to Policy Statement (PS19/4) which provides guidance to funds regarding key information document disclosure of environmental and social objectives, so this may be the direction of travel for other products.

Engagement with the work being undertaken by the EU under its EU Sustainable Finance Action Plan is another area of focus, in particular in relation to regulations being developed on disclosure and the taxonomy. It is worth noting here that although the initial proposals under the EU Sustainable Finance Action Plan to provide specifically for green bond issuance under the Prospectus Regulation have not yet materialised, the European Technical Expert Group on sustainable finance have published proposals for a voluntary EU Green Bond Standard. The Commission is currently considering these proposals.

Joint work with Government, other regulators and industry
Promoting sustainable finance is a key issue for governments, policy makers, regulators and businesses, as demonstrated by the creation in December 2017 of the Network of Central Banks and Supervisors for Greening the Financial System (NGFS).

The FCA notes its collaboration with others on a number of initiatives, such as the PRA in relation to the Climate Financial Risk Forum and internationally with IOSCOs Sustainable Finance Network and the EU's Sustainable Finance Action Plan to name a few. All of this has informed its policy and supervisory approach. Such international collaboration looks sets to continue. Given how serious regulators and policy makers appear to be about tackling this issue, industry players should expect to see more climate-related regulatory initiatives in the pipeline in the near future.

The UK financial system's resilience to climate change risk and the transition to a low-carbon economy

The publication of the Feedback Statement follows an appearance by Mark Carney at the Treasury Select Committee's Evidence Session on the Bank of England's Financial Stability Report, during which he highlighted that, in 2021, the Bank will be conducting a stress test of the UK financial system's resilience to climate change risk and the transition to a low-carbon economy. The Governor also pointed out the importance of developing credible climate risk policies in order for the financial sector to anticipate changes in the market (for example, an increase in carbon-pricing) and value companies appropriately. According to Dr Carney, the capital markets are currently pricing their portfolios consistent with approximately 4 degrees warming, which he cites as evidence that current climate policy is not yet consistent with stabilising temperatures to below 2 degrees. In the Governor's opinion, for central banks to ensure that the financial system is ready for climate-related financial stability risk, the system needs:

- better reporting (and Dr Carney again highlighted his preference for making TCFD-related disclosure mandatory within two years)
- a globalised stress-testing approach
- individuals and society to be able to assess whether their money is invested consistent with the goal of "net zero".

As noted by Dr Carney, a global approach is imperative and the stakes are high. At the October 2019 IMF Annual Meeting in Washington, for example, Kristalina Georgieva, Managing Director of the International Monetary Fund, pointed to "at least $12tn of high carbon-emitting assets" that could become stranded assets. As a result, central banks are increasingly adjusting their regulatory and monetary policy frameworks to address climate risks, hence the need for coordination. We are therefore likely to see much more from central banks on this topic, particularly in relation to disclosure and stress-testing.

Timeline and next steps

2019

Q4 2019
Finalising rules and consulting
- FCA to publish
  - Feedback Statement on Stewardship
  - Policy Statement on Independent Governance Committees
- FCA to engage
  - with firms to clarify expectations around green financial products and services
  - with the expected EU Sustainable Finance Action Plan proposals around benchmarks and disclosures

2020

Q1 2020
Collaborating with Government, other regulators and industry
Likely to continue beyond Q1 2020

Key developments
- Consultation Paper on new issuer disclosure rules and clarifying existing requirements
- Finalising proposed rule changes to facilitate investment in patient capital opportunities (may extend beyond Q1)
- Further policy analysis on greenwashing, including the publication of guidance as appropriate.
- Engaging with and considering further development of the EU Sustainable Finance Action Plan
- Publication of initial outputs from the Climate Financial Risk Forum
- Contributing to the Fair and Effective Markets Review working group and Government-led cross-regulator taskforce on disclosures

Q2 2020 and beyond
Future priorities on climate change and green finance
- FCA to provide an update on work and future priorities on climate change and green finance as part of the adaption report to be submitted to DEFRA ahead of the 2021 deadline

CONTACTS

Kavita Bassan
Senior Associate
Knowledge Lawyer
Corporate Group
T: +44 20 7006 5826
E: kavita.bassan@
cliffordchance.com

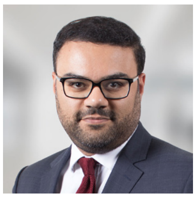
Clare Burgess
Partner
Capital Markets Group
T: +44 20 7006 1727
E: clare.burgess@
cliffordchance.com

Michael Coxall
Knowledge Director
Environment Group
T: +44 20 7006 4315
E: michael.coxall@
cliffordchance.com

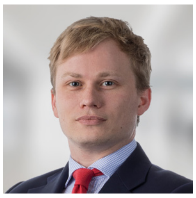
Caroline Dawson
Partner
Financial Services
Regulatory Group
T: +44 20 7006 4355
E: caroline.dawson@
cliffordchance.com

Nigel Howorth
Partner
Environment Group
T: +44 20 7006 4076
E: nigel.howorth@
cliffordchance.com

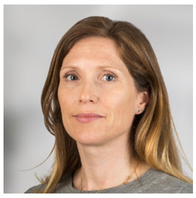
Jacqueline Jones
Knowledge Director
Financial Services
Regulatory Group
T: +44 20 7006 2457
E: jacqueline.jones@
cliffordchance.com



Daud Khan
Partner
Corporate Group
T: +44 20 7006 6069
E: daud.khan@
cliffordchance.com

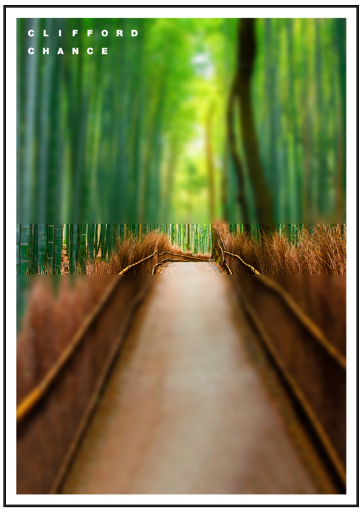


Owen Lysak
Partner
Financial Services
Regulatory Group
T: +44 20 7006 2904
E: owen.lysak@
cliffordchance.com



Jessica Walker
Knowledge Director
Capital Markets Group
T: +44 20 7006 2880
E: jessica.walker@
cliffordchance.com

GROWING THE GREEN ECONOMY



We have a number of other articles included in our publication **GROWING THE GREEN ECONOMY:** ADDRESSING THE SUSTAINABILITY CHALLENGES AND OPPORTUNITIES that look at developments in ESG and sustainable finance.

The severe warnings on climate change starkly documented by the IPCC report and others demonstrate why urgent action to meet the goals of the Paris Agreement is needed. The public, governments and legislators are taking notice and taking action. Much of the legislative effort to date has been focused on the financial system but there is an increasing emphasis on non-financial entities and the requirements that are beginning to be expected of them. These requirements stem from legislation, public pressure and possible litigation.

GROWING THE GREEN ECONOMY reflects the breadth and depth of the impact of these environmental and sustainable factors. **Visit www.cliffordchance.com/greeneconomy** to read and download the publication in full.

CLIFFORD

CHANCE

www.cliffordchance.com

Clifford Chance, 10 Upper Bank Street, London, E14 5JJ

Abu Dhabi • Amsterdam • Barcelona
Beijing • Brussels • Bucharest
Casablanca • Dubai • Düsseldorf
Frankfurt • Hong Kong • Istanbul
London • Luxembourg • Madrid
Milan • Moscow • Munich • Newcastle
New York • Paris • Perth • Prague
Rome • São Paulo • Seoul • Shanghai
Singapore • Sydney • Tokyo • Warsaw
Washington, D.C.

Clifford Chance has a co-operation agreement with Abuhimed Alsheikh Alhagbani Law Firm in Riyadh.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.

RECYCLED
Paper made from recycled material
FSC® C012830
www.fsc.org

1910-000401