ICAEW
REPRESENTATION 80/20

PROPOSALS TO ENHANCE CLIMATE-RELATED DISCLOSURES BY LISTED ISSUERS AND CLARIFICATION OF EXISTING DISCLOSURE OBLIGATIONS

Issued 2 October 2020

ICAEW welcomes the opportunity to comment on the *Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations* published by The Financial Conduct Authority (FCA) on 6 March 2020, a copy of which is available from this link.

ICAEW is pleased to have the opportunity to respond to the FCA's proposals. We believe that having appropriate climate-related disclosures is vital to ensure that investors receive the material climate-related information needed for efficient and effective capital allocation to drive the transition to a low carbon economy. There has been already some progress in this respect in the last few years but it is widely recognised that more work is needed to ensure that the reporting on material climate-related financial risks is of sufficient quality and detail to support decision-making by investors and others.

This response of 2 October 2020 has been prepared by the ICAEW Financial Services Faculty, liaising with the ICAEW Financial Reporting Faculty. As a leading centre for thought leadership on financial services, the Financial Services Faculty brings together different interests and is responsible for representations on behalf of ICAEW on governance, regulation, risk management, auditing and reporting issues facing the financial services sector. The Faculty draws on the expertise of its members and more than 25,000 ICAEW members involved in financial services.

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MAJOR POINTS

SUPPORT FOR IMPROVED CLIMATE-RELATED DISCLOSURES

1. ICAEW is committed to ensuring that chartered accountants are at the forefront of efforts to tackle the severe challenges arising from climate change. We have long been strong supporters of the distinctive approach adopted by the TCFD which focuses on communication of the financial impact of climate change on the reporting organisation. We continue to believe that TCFD will contribute to improvements in the quality and consistency of disclosures and governance in this area. It is within this context that we have reviewed the FCA's proposals.
2. When considering the FCA's proposals we have taken into account the urgent need to tackle climate change, the practical challenges for companies when capturing relevant data and the subsequent reporting of that data, and the interrelation with existing and forthcoming reporting requirements on climate-related matters. Overall, we support the FCA's proposals and efforts to improve climate-related disclosures in the annual reports of premium-listed issuers. Therefore, our comments below are focussed towards highlighting practical challenges that might arise in the shorter-term for premium-listed issuers when reporting in line with the TCFD framework, and possible ways to assist companies with any reporting requirements.

ANSWERS TO SPECIFIC QUESTIONS

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?

3. Yes, we broadly agree that the new rule should apply only to commercial companies with a premium listing. However, we note that the proposed implementation date for the new rule would be 1 January 2021. Based on the feedback we have received from our members, collation of data and reporting in line with TCFD within this timeframe might be difficult, not only for smaller quoted companies but for larger ones too.
4. One approach could be for the FCA to consider introducing a phased implementation of the requirements (for example, focussing first on larger premium listed entities before expanding the scope more widely). A solution like that might help address practical concerns with the proposed implementation date and ensure better quality reporting. Another approach might be to require premium listed entities to provide the disclosures under the governance and risk management recommendations in the first year of application, with the more complex disclosures to follow in subsequent years.
5. More broadly, we note that the UK Government has recently stated its intention to introduce TCFD reporting requirements to a broader set of companies in the near future. That is not to say that the FCA should delay moving ahead with the proposals in this consultation (subject to our comments on the implementation timetable). However, it would be helpful to keep in mind these future expected regulatory changes when developing the new rules ie, to make sure they can be easily updated or amended as required without undue cost or effort.

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?

6. We agree with the scoping suggestion as described in the question. Sovereign control commercial organisations are often very large and could have significant economic impact. This is notwithstanding the suggestion of phased introduction of the requirements as described above.

Q3 Do you agree with our approach?

7. Yes, we agree with the approach described in the consultation document. Climate change itself and the response to it will impact the value of companies, mostly through the changes they will have to implement to either mitigate risks or benefit from opportunities.
8. We agree that the objective of the proposal is to increase transparency to ensure that securities are more accurately priced. The ultimate aim is the efficient allocation of capital to help accelerate the transition to the low carbon economy.
9. We agree with the notion that the requirements described in the proposal are aligned with the TCFD recommendations. This is in light of our view that the market is unhelpfully awash with documents published by various UK, European and global organisations all with the purpose of enhancing climate-related disclosures. While the aim of these organisations is laudable, the sheer volume of directives, regulations and guides perhaps triggers inertia in firms, who may not be able to decide what to comply with. The fact that TCFD was the first global organisation that has produced recommendations coupled with their suitability and adaptability to all organisations supports the approach of alignment with its proposals.

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?

10. We agree that the rule should reference the 4 recommendations and 11 supporting disclosures included in the TCFD. This will further enhance alignment between companies, which will strengthen transparency and consistency in the marketplace. Furthermore, by referencing the exact recommendations and disclosures, the FCA is encouraging the premium issuer to become familiar with the detail of the TCFD recommendations.

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

11. We agree that it would be helpful to refer to the guidance that exists. Some preparers might suggest that it would be helpful to produce a shortened and summarised guidance for issuers. However, we believe that while it may appear lengthy, the additional guidance will help issuers to produce disclosures that demonstrate their management of the risks as well as provide some consistency in the marketplace.

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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?

12. We agree that publication of guidance which references the wider set of materials would be helpful.
13. We are also aware of concerns about the large number of initiatives in the UK which apply to different types of company, including the streamlined energy and carbon reporting requirements in the directors' report and the requirements of the EU Non-Financial Reporting Directive in the strategic report. To achieve the goals of the TCFD and other initiatives, it would be helpful to have greater coordination and a streamlined approach. For example, it might be helpful to have comprehensive and cohesive FCA guidance which covers the TCFD requirements, with reference to other related initiatives. This would help market participants understand what is required of them.
14. We also recommend that the FCA monitors progress towards the development of a suite of international non-financial reporting standards and assesses the position of TCFD within any such standards. ICAEW is supportive of the establishment of a single principles-based and internationally recognised global framework for non-financial reporting. Please see our Non-financial reporting: ensuring a sustainable global recovery for further information.
15. Looking ahead, we also suggest that when appropriate, and market developments justify it, the FCA (together with other organisations) could helpfully encourage the TCFD to carry out a post-implementation review to take into account scientific developments, technological advances and feedback from those who have implemented their recommendations. While this would not affect the proposals set out in this consultation, we believe that the outcome of any such review would provide helpful information on how the requirements might evolve and improve over time.

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?

16. When considering the proposed 'comply or explain' approach we have considered the challenges arising from the implementation timetable, and whether the nature of TCFD enables companies to state 'compliance' given that it is a principles-based framework designed to help companies consider climate and reporting.
17. On balance, we broadly agree with the proposed comply or explain approach. As highlighted above the proposed timeframe for implementation may be challenging and in our view the comply or explain approach, which is already a familiar approach adopted for other requirements, would enable premium issuers to develop their systems and processes over time.
18. Also, as discussed, the UK Government has stated its intention to introduce TCFD reporting requirements to a broader set of companies in the near future. In our view, the FCA's comply and explain approach will helpfully introduce the TCFD framework to premium listed entities at an earlier stage and ensure that they are better prepared for future regulatory requirements. As note noted, it would be helpful for the FCA to keep in mind these future expected regulatory changes when drafting their own requirements ie, to make sure the rules are easy to update or amend as required without undue cost or effort.

Q8 Do you agree that the recommended disclosures under "governance" and "risk management" recommendations should not be subject to materiality assessment? If not, what alternative approach would you prefer and why?

19. We agree with the requirement as described in the question. Information on a company's governance and risk management procedures provide an important insight into a company's understanding and approach to climate-related risks and opportunities. Investors would want to understand how their investee companies manage and mitigate the risks and how they propose to benefit from the opportunities.

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

20. Yes, we agree. Ensuring that governance and risk management appropriately considers climate-related risks and opportunities by setting up suitable governance and risk management measures should not be negotiable. These measures do not require particularly onerous resources, experience and data collection efforts. They will, however, demonstrate that issuers are making appropriate efforts not only to comply with the requirements but to actually include these risks in their 'business as usual'.

Q10 Do you agree that no explicit reference 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?

21. Yes, we agree. It might, however, be helpful for the FCA to clarify the expectation that the disclosures on governance and risk management (as discussed in question 8 and 9) will be provided except in exceptional circumstances.

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

22. We agree with the inclusion of the statement of compliance in the annual financial report. This is in line with the TCFD recommendations. We note that this will make the statement subject to the same audit procedures applicable to the narrative part of the annual report.

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?

23. Inclusion of the full extent of TCFD information (in particular all of the detailed scenario analysis) should not be required in the annual report as this could run to many pages of detailed analysis. This may add clutter to the annual report and could result in unbalanced reporting (ie, lots of information on climate risk compared to other risks).

24. In our view, it would be better to require a summary of the TCFD information in the annual report with a cross reference to the full and more detailed information located outside of the annual report. It would be important for the TCFD information located outside of the annual

report to still be published at the same time as the annual report ie, to have the same publication timeframe.

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.

25. While we believe that audit and assurance will be important in ensuring that issuers comply with the regulations, we agree that at the moment expecting third-party assurance would be premature. Many issuers are still at an early stage of developing the management of their climate-related risks and opportunities. The requirement of third-party assurance would be likely to encourage them to concentrate on disclosures. This could in turn stifle their efforts and innovation in developing suitable methods for reporting under the TCFD framework.

26. We also take this opportunity to consider the ongoing and important debate regarding the assurance of non-financial information. In our view, one of the major challenges to providing assurance on non-financial information is the strength of an organisation's control systems and governance structures that support the process of producing the information. A common refrain heard in ICAEW's engagement with assurance providers is that they are often unable to accept assurance engagements of non-financial information when the organisations control system is not mature enough, as it leaves them unable to rely on the system as part of the engagement.

27. In order for assurance of non-financial information to become more commonplace, it will be necessary to up-skill boards and audit committee chairs, strengthen the control systems and reporting processes. These are not quick fixes and will take a concerted effort to move forward.

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

28. We would raise a concern about the implications of the proposed new rule for sponsors' declarations for Class 1 transactions (LR 8.4.12). For example, if an issuer is acquiring a private company and has had limited access to the target's compliance with TCFD, the acquirer may not be in a position to consider the effect of integration on the expanded group. It may be that issuers/acquirers choose to explain rather than comply in relation to years where there has been a Class 1 acquisition, but we are unsure whether this would be acceptable to investors and what view the FCA would expect sponsors to take in relation to their declaration if the acquirer stated that to be the case.

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?

29. As noted above, we believe that the annual report should include a statement of compliance, with the full extent of TCFD information (including the detailed scenario analysis) presented elsewhere. We acknowledge that a balance is needed to ensure that the annual report still provides sufficient and helpful information but with clear cross references to further detail.

30. We also accept that there may be legal implications to take into consideration when information is presented outside of the annual report. Equally, it might be that disclaimers are needed for 'climate scenario analysis' information to clarify that it is not a forecast/market guidance to avoid investors treating it as such. It will be important for these matters to be

considered as the FCA finalises these requirements and providing guidance where appropriate.

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?

31. Yes, we believe that introducing the requirements on a 'comply or explain' basis (as discussed elsewhere in this response) and the FCA's plan to monitor developments and guidance on TCFD will be helpful to address the challenges and risks identified in the consultation.

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?

32. The proposed effective date looks challenging, particularly since the consultation period was extended. We would ordinarily suggest that the effective date is also delayed, which would allow more time for companies to prepare and start collating data etc. A delay might also be welcome in light of the many challenges currently facing companies as a result of the Covid-19 pandemic.

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

33. It is very helpful to see actual numbers and amounts in the cost and benefit analysis. We appreciate the effort the FCA made in researching relevant remuneration and estimated time needed to calculate the costs. We have not performed our own research but can certainly see the reasonableness of the figures. We agree that considering the overall cost, even a marginal improvement in managing the financial risks would be beneficial.

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

34. We agree with the guidance provided in the Technical Note.