Principles for Responsible Investment

# CONSULTATION RESPONSE

## FINANCIAL CONDUCT AUTHORITY: PROPOSALS TO ENHANCE CLIMATE-RELATED DISCLOSURES BY LISTED ISSUERS AND CLARIFICATION OF EXISTING DISCLOSURE OBLIGATIONS

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## ABOUT THE PRI

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI is now a not-for-profit company with over 3,000 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with approximately US $90 trillion in assets under management. 474 of these signatories, representing $9 trillion, are based in the United Kingdom.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

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## SUMMARY OF THE PRI'S POSITION

The PRI welcomes the FCA moving towards improving the quantity and quality of information relating to the financial risks arising from climate change. This is aligned with the FCA's core function of ensuring that markets work well.

The PRI recommends that the FCA goes further than the proposal it has published here. The scale and urgency of climate change means taking action now. The growth in investors undertaking TCFD reporting and inbound legal requirements for pension funds reinforce the need for more comprehensive disclosures from issuers. As hosts of COP26 and as home to one of the world's main financial centres, several other markets look to the UK's proposals to inform their own decision-making. Leadership on TCFD implementation by the UK would support increased global ambition on climate reporting.

In addition to the disclosure of financial risk, there is an expectation that companies and investors should align their economic activities with a net zero by 2050 trajectory. The Race to Zero campaign has seen over 1,100 companies commit to achieve net zero greenhouse gas emissions by 2050 at the latest, with many setting earlier targets. TCFD is a necessary foundation to ensure granular and comparable disclosures to hold companies to account for such commitments, though further disclosures may be required.

The PRI recommends that the FCA:

1. **Introduce the rules on a mandatory, rather than 'comply or explain', basis**. A comply or explain approach would lead to a patchwork of disclosures which would hamper efforts to address market information failures.
2. **Broadens the scope of the proposals to include all issuers listed on the Main Market**. The current limited scope risks concentrating climate-related financial risk in smaller, less resilient issuers.
3. **Go beyond the recommendations of the TCFD to explicitly require disclosure of issuers' alignment with the Paris Agreement.** The information needs of investors has evolved beyond the climate-related risk exposures which the TCFD focuses on, to how companies are aligned with and contributing to the transition to a net zero economy.

# 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?

No, the PRI recommends expanding the scope of the rule to include all issuers listed on the Main Market of the London Stock Exchange.

Since the FCA published its discussion paper on *Climate change and green finance* in October 2018, there has been a significant increase in recognition of the scale of the financial risks posed by climate change among businesses, investors and policymakers, and an appetite to take action. The UK has committed to net zero greenhouse gas emissions by 2050 at the latest, as have many businesses, investors and regions.[1]

There is appreciation by government that companies and financial markets need to support rather than undermine this net zero objective.[2] Notably, the Pensions Bill would require large pension schemes to disclose against the TCFD recommendations and the extent to which they are aligned with the Paris Agreement, as well as to gather emissions data on a quarterly basis, or face penalties.[3]

Compliance with the Bill's requirements will necessitate granular decision-useful disclosures from UK-listed companies, where a substantial portion of domestic pension assets are invested.[4] Restricting application of the proposed rule to companies with a premium listing would impede pension trustees and other users of these disclosures from accessing necessary information on climate risk for close to 40% of the Main Market's market capitalisation. This is particularly concerning considering that the global warming potential of the London Stock Exchange is estimate at 3.8 degrees.[5]

A broader scope of issuers would be consistent with action taken internationally. For example, New Zealand has recently proposed TCFD reporting requirements for all listed issuers and large financial institutions.[6] The EU's revised Non-Financial Reporting Directive would apply to listed and unlisted companies. Ensuring access to comprehensive data on one of the major systemic risks facing issuers and investors is necessary to maintain London's competitiveness as a major financial centre. At a minimum, the FCA should disclose a timeline for expanding TCFD reporting to all Main Market issuers at the earliest opportunity.

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[1] https://unfccc.int/climate-action/race-to-zero-campaign#eq-2

[2] https://www.gov.uk/government/speeches/pension-funds-can-be-the-spring-board-to-real-change-to-a-net-zero-economy

[3] https://publications.parliament.uk/pa/bills/cbill/58-01/0165/200165.pdf

[4] See, for example, p. 35 for a typical asset allocation for a UK DB scheme: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/642456/financing_growth_in_innovative_firms_consultation_web.pdf

[5] https://www.avivainvestors.com/en-gb/views/aiq-investment-thinking/2019/11/trying-to-square-the-circular-economy/

[6]

**Q2. Do you agree that sovereign-controlled commercial companies with a premium listing should also be in scope?**

Yes, the PRI supports the inclusion of sovereign-controlled commercial companies within the scope of the proposal.

**Q3. Do you agree with our approach? [on asset managers with a premium listing]**

Yes, the PRI supports the proposed approach for regulated firms with a premium listing. However, as noted above pension trustees will be dependent on granular upstream disclosures which can be aggregated across a portfolio, which will require greater disclosure not only from listed companies but also asset managers, on a product-specific basis. As such the PRI urges the FCA to clarify its approach regarding TCFD reporting by regulated firms.

**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?**

No, the PRI recommends introducing the new requirement on a mandatory basis. While not all issuers may have developed the capabilities to make all recommended disclosures – for example, on scenario analysis – a preferable approach would be to allow issuers to comply by making principles-based disclosures where necessary in the first year of the rule coming into force.

As set out above in response to Q1, comprehensive and comparable disclosures from issuers on their exposure to climate risk is necessary to ensure that markets work well. There has been a significant growth in the number of investors reporting against the TCFD recommendations who are dependent on adequate corporate disclosure. For example, among PRI signatories there has been a 350% increase in TCFD-based investor reporting in the first quarter of 2020, with 2,097 investors (443 asset owners, 1,654 asset managers) representing $89 trillion in assets reporting, compared with 591 investors the previous year. 330 of these investors were based in the UK – the second largest market by number of investors.[7]

These numbers will continue to grow. An additional 700 PRI signatories were under a reporting grace period as of this year but will report in 2021. Regulations under the Pensions Bill will also require all pension funds with at least £5 billion in assets and all authorised master trusts to report against the TCFD recommendations from 2022 (and all schemes with £1 billion in assets from 2023). The comply or explain approach proposed in this consultation would lead to a patchwork of disclosures which would hamper efforts to address market information failures.

UK-based investors are dependent on disclosures not only from UK-based companies, but also from companies headquartered abroad. A clearer signal on a TCFD mandate from the UK, particularly

[7] https://www.unpri.org/climate-change/pri-climate-snapshot-2020/6080.article

given their status as hosts of COP 26, could have the additional effect of encouraging similar ambition from other governments and improving the overall ecosystem of information on climate risk.

It is also worth noting that UK issuers have had significant advance notice of the potential for a TCFD reporting requirement. The FCA first raised the possibility of such a requirement in its 2018 discussion paper, while the Green Finance Strategy also contained an expectation that all listed issuers would report against the TCFD recommendations by 2022. As such issuers have had sufficient opportunity to invest in capacity building to undertake TCFD reporting. Given this lead-in time, further "signalling" via an initial comply or explain requirement would seem unnecessary.

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

Yes, the PRI supports the inclusion of these disclosures within the issuer's annual financial report.

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

Yes, the PRI agrees that third-party assurance of issuers' climate-related disclosures should not be required at this time. However, the PRI recommends that the FCA set expectations regarding by when assurance of disclosures may be required.

**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 PRI recommends that, in addition to the TCFD recommended disclosures, the FCA should also require issuers to disclose a strategy on the extent of their alignment with the goals of the Paris Agreement.

Since the TCFD recommendations were formulated, a number of the world's largest economies have committed to achieve net zero greenhouse gas emissions by 2050 or sooner, including the UK. Partially as a result of this, the information needs of investors has evolved beyond the climate-related risk exposures which the TCFD focuses on, to how companies are aligned with and contributing to the transition to a net zero economy.[8] Encouraging companies to devise and disclose a strategy to achieve net zero emissions by 2050 is a key objective of Climate Action 100+, an initiative of over 450

[8] https://www.responsible-investor.com/articles/with-the-tcfd-in-its-fifth-year-it-s-time-to-make-net-zero-mandatory-for-financial-institutions

investors engaging with over 160 of the world's highest emitting companies. While an increasing number of companies have disclosed high-level commitments to achieve net zero emissions by 2050, the details of that commitment have varied and few companies have provided details of how practically their strategy will align with such a commitment. For companies who have made no such commitment, investors' ability to evaluate the compatibility of investee companies' strategies with a 1.5 degree scenario is constrained.

Capacity is still evolving in this space. A rule such as that proposed here should involve a period of time for industry innovation, evolution and harmonisation on approaches and methodologies for Paris Agreement alignment, as well as dialogue with key international initiatives and actors advancing good practice in this area. The FCA should indicate a timeline by which such disclosures should be made.

**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?**

Yes, the PRI supports the proposed timeline for TCFD reporting.