KEY POINTS

- The discourse around disclosures is constantly evolving, but the Task Force on Climate-related Financial Disclosures (TCFD)'s recommendations on climate-related disclosures are becoming increasingly established as the global minimum standard.
- The FCA's current proposals will initially apply to UK premium-listed issuers including certain financial services firms (in their capacity as issuers) from the publication of their 2021 accounts, but the scope may be extended in the future to include open-ended and closed-ended investment companies and issuers with a standard listing.
- It is clear that climate-related disclosures are high on the regulatory agenda and are being increasingly viewed as key areas of interest for investors. Going forwards, closer attention will be paid both by the FCA and likely by investors to climate-related disclosures made by issuers. This greater scrutiny may result in an increased risk of litigation under s 90 FSMA, s 90A FSMA, or in common law or equity.

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Climate-related disclosures: the new frontier?

What do eight Pacific islanders, Greta Thunberg and the Financial Conduct Authority (FCA) have in common? Climate change. In this article we examine the FCA's proposals for regulating climate-related disclosures and the litigation risks which may arise for issuers from such proposals.

INTRODUCTION

Climate change has been part of the political and regulatory discourse for years. However, it is an issue which has gained increasing prominence on the global stage, whether through the initial political drive of the 2015 Paris Agreement, the recent political announcements in the UK in response to the COVID-19 pandemic, the actions and demonstrations prompted by prominent environmental activists such as Extinction Rebellion and Greta Thunberg, or the social change on your doorstep from Keep Cups to recycling bins. Its prominence does not stop at either the political or the popular: investors are becoming increasingly interested in and aware of climate-related risks attaching to investments. Over a thousand companies now support the Task Force on Climate-related Financial Disclosures (TCFD)'s recommendations, while shareholder activism in the climate arena is stretching beyond Greenpeace's proposed resolutions at energy companies' AGMs. Earlier this year, a shareholder resolution in relation to the management of climate exposures in Barclays' governance arrangements garnered c.24% shareholder support, and a shareholder resolution into Total's emissions targets was filed/co-filed by asset managers and insurance companies rather than organised climate activists.[1]

Against this backdrop, both the EU and the UK have advocated for adapting their financial systems to address climate risks. In an effort to accelerate greater transparency posed by the risks of climate change, the European Central Bank (ECB) is planning to carry out stress tests of climate risk in 90 important financial institutions in the Eurozone during 2021. In a similar move, the Bank of England (BoE) is planning to include the impact of climate change in its UK bank and broader financial system stress tests in 2021 as part of its ongoing remit to safeguard and mitigate threats to the UK's financial stability.

Whilst the ECB and the BoE are addressing the risks arising from climate change in their financial systems, attention has also turned to how companies themselves can be affected by climate change, both in terms of risk assessment and management, and in terms of investor and market-facing disclosures. The current legal framework regarding issuer disclosure already provides some requirements for issuers to disclose climate-related risks in certain circumstances. However, the existing disclosure requirements fall short when it comes to consistent and meaningful disclosures. There are therefore systemic and policy drivers to increase transparency, reporting and potential regulation in this space.

In order to progress climate-related disclosure in the market, the Financial Stability Board set up the TCFD in 2015. The mission of the TCFD is to "develop voluntary, consistent climate-related financial risks disclosures for use by companies in providing information to investors, lenders, insurers, and other stake holders … The work and recommendations of the Task Force will help companies understand what financial markets want from disclosure in order to measure and respond to climate change risks, and encourage firms to align their disclosures with investors' needs".[2] In 2017, the TCFD published a set of recommendations, which outlined a voluntary global framework for climate-related financial disclosures (aimed at assisting investors with understanding which companies are at most risk, which ones are best prepared and which are taking action). This gained significant support from issuers and investors with 1,440 organisations supporting the TCFD, representing a market capitalisation of $12.6 trn[3] including 111 banking institutions, and with some market participants starting to disclose in line with these recommendations.

The BoE encouraged firms to engage with the TCFD's recommendations in its April 2019 Policy Statement. Looking to lead by example, in June 2020 the BoE published its own Annual Report and Accounts along with its first accompanying climate-related disclosures, which it produced in line with the TCFD's recommendations.[4]

The FCA is participating in a cross-regulator taskforce[5] on TCFD implementation as part of the UK government's Green Finance Strategy, which contains an expectation that all listed issuers and large asset owners will be disclosing in accordance with the TCFD's recommendation by 2022. The FCA has noted that voluntary adoption of the TCFD's recommendations has been increasing. However, based on the feedback that the FCA received in response to a 2018 Discussion Paper,[6] the FCA considers that there is evidence to support the case for it to intervene to accelerate such progress.

This article examines the existing disclosure requirements for issuers, the FCA's new proposals for regulating climate-related disclosures, the FCA's reasons behind the proposals, how issuers will be impacted by the proposed regulatory change, the litigation risks which may arise for issuers and how issuers can mitigate against such litigation risks.

WHAT ARE THE EXISTING DISCLOSURE REQUIREMENTS THAT ISSUERS NEED TO COMPLY WITH?

Existing disclosure obligations require issuers to report the implications of Environmental, Social and Corporate Governance (ESG) factors, where these are financially material or in certain other circumstances. Such disclosures are intended to help the market reach an informed view on the value of the traded securities.

The key existing rules that may require or relate to ESG-connected disclosures include the Listing Rules (LR), the Prospectus Regulation (PR), the Disclosure Guidance and Transparency Rules (DTR), Market Abuse Regulation (MAR), the UK Corporate Governance Code 2018 (Code), and UK Companies Act 2006 (CA 2006).

The LR, for example, provide that:

- Timely and accurate disclosure of information to the market is a key obligation.[7]
- A premium-listed issuer must communicate information to holders and potential holders of its premium-listed securities and its listed equity shares in such a way as to avoid the creation or continuation of a false market.[8]
- Every circular sent by a premium-listed company to holders of its listed securities is to contain:
  - a clear and adequate explanation of its subject matter giving due prominence to its essential characteristics, benefits and risks; and
  - if action is required, all information necessary to allow the security holders to make a properly informed decision.[9]
- An issuer is to take reasonable care to ensure that any information it notifies to a regulatory information service (RIS) or makes available through the FCA is not misleading, false or deceptive and does not omit anything likely to affect the import of the information.[10]

The PR, for example, provides that:

- The prospectus must contain the necessary information which is material to an investor for making an informed assessment of (amongst other things) the assets and liabilities, and the prospects, of the issuer.[11]
- Material risk factors are to be included.[12]

The DTR and CA 2006, for example, provide that the management report in the annual financial report must contain a description of the principal risks and uncertainties facing the issuer and a fair review of the issuer's business. The review must include key performance indicators, including information relating to environmental matters and employee matters.[13]

The MAR, for example, provides that an issuer is to disclose publicly inside information which directly concerns it as soon as possible; this will include any inside information which relates to climate change and other ESG matters.[14]

The Code, for example, recommends that companies report on how they have considered opportunities and risks (which may include those that are ESG-related) to the future success of their business.

WHAT IS THE FCA'S PROPOSED REGULATORY CHANGE?

In March 2020 the FCA published a Consultation Paper[15] setting out its proposals for promoting the adoption of the TCFD's recommendations and recommended disclosures.

The Consultation Paper contains two key elements:

- The introduction of a new climate-related rule requiring commercial companies with a UK premium listing (including sovereign-controlled commercial companies) to state in their annual financial report whether they have complied with the TCFD's framework, where in the annual financial report the various disclosures can be found, and to provide an explanation for any non-compliance.
- The issue of a Technical Note clarifying existing disclosure obligations which issuers may already be subject to under existing EU legislation and rules and the FCA Handbook.

The FCA's proposals are designed to enhance climate-related disclosures by premium-listed issuers, to clarify disclosure obligations and to encourage the consistency of such disclosures with the TCFD's framework.

The consultation was initially due to close on 5 June 2020, but this deadline was extended to 1 October 2020 due to the COVID-19 pandemic. Subject to the feedback received, the FCA aims to publish a Policy Statement along with the finalised rules. However, the FCA's approach will need to take account of other regulators' approaches and the EU's proposed Sustainable Finance Disclosure Regulation (which contains mandatory disclosure requirements).

The FCA's proposals, if adopted, will apply to accounting periods beginning on or after 1 January 2021. The first published reports to be issued in compliance with such proposals would be published in 2022.

There was some discussion around whether the FCA's proposals went far enough – the Consultation Paper's proposals are set out on a "comply or explain" basis rather than a proposed mandatory change with enforceable teeth. However, this is broadly in line with the general approach being adopted by the UK regulator, to encourage and nudge the industry towards a more considered and rigorous approach to climate risk. While we are very much at the carrot stage with the FCA and BoE, the likelihood is that a stick will follow not long after.

WHO WILL BE AFFECTED BY THE FCA'S PROPOSED REGULATORY CHANGE?

The new climate-related disclosure rule will directly impact commercial companies (including sovereign-controlled commercial companies and any financial services firms) with a UK premium listing. The FCA has noted that open-ended and closed-ended investment companies are not affected by the proposals. However, as capabilities evolve the FCA may consider extending the scope of the proposals to these companies and other listed issuers, such as issuers with a standard listing.

The Technical Note will impact a wider scope of issuers, such as listed issuers, issuers with securities admitted to trading on regulated markets and other entities falling within the scope of the requirements under MAR and the PR.

WHY IS THE FCA INTRODUCING THE PROPOSED REGULATORY CHANGE?

The Consultation Paper is part of the FCA's strategy to ensure that markets function well and that there is continued market integrity, consumer protection and competition.

The FCA notes that the value of a company's assets or future profits can be susceptible to climate change or changes in policy responses to climate change. The FCA is therefore keen to encourage greater transparency about the impact of these to premium-listed issuers and consequently any investors. The FCA considers that the new rule will:

- Introduce clear regulatory requirements. These will encourage high quality disclosures by issuers of information which is required by investors for their decision-making. Such requirements also enable issuers to reduce their costs in dealing with *ad hoc* information requests from investors and improve their climate change strategy and risk management.
- Encourage the accurate pricing of securities. Inconsistent or insufficient disclosures may lead to assets being mispriced due to the market being unable to determine their true value.
- Support improved disclosures which will enhance the development of the market for green financial products. Financial services firms will have access to reliable data on companies' climate strategies and performance, which in turn will enable them to disclose how their portfolio and products are affected by opportunities and risks relating to climate change.
- Promote the efficient allocation of capital.

HOW WILL LISTED ISSUERS BE AFFECTED BY THE FCA'S PROPOSED REGULATORY CHANGES?

Depending on the views of key stakeholders received for this Consultation Paper, the FCA may either carry out a further consultation or take steps to introduce formally the new climate-related disclosure rule for premium-listed issuers to comply with. The FCA has noted a further consultation may be held in the future when further data or industry guidance on the implementation of the TCFD's recommendations becomes available over time.

The FCA has indicated it does not envisage the new rule being a strict requirement for premium-listed issuers at this point in time as it recognises that:

- climate change is a developing area and that it may not be appropriate to set binding requirements which are not yet achievable (eg issuers may not yet have the data and capability to model and report scenarios as recommended by the TCFD); and
- the need for balancing proportionately the interests of both issuers and investors.

The FCA notes that in most G20 countries, listed issuers are already subject to an obligation to disclose material information in their financial filings (eg as per the rules in the FCA Handbook, EU legislation, the UK Corporate Governance Code 2018 or the UK Companies Act 2006); this implies that any material impacts of climate change for the issuer and the issuer's response to these should be disclosed in any case.

However, if the new rule is introduced formally in the UK, it is likely that closer attention may be paid by the FCA and investors to climate-related disclosures made by premium-listed issuers.

Whether such climate-related disclosures increase the litigation risk profile for premium-listed issuers will depend on, amongst other things:

- The extent to which such issuers and firms already provide such required disclosures in accordance with the TCFD's recommendations.
- Whether the disclosures provide:
  - an accurate assessment of the value and investment risk of the associated securities.
  - accurate and sufficient information on the exposure of such issuers and firms to climate-related risks and opportunities.
- Appropriate caveats and assumptions being included. The regulatory guidance makes clear that in this fast-moving area, something is better than nothing, and that perfection is the enemy of the greater good. With that in mind, the FCA is encouraging firms to consider climate-related risks and opportunities, stress testing and strategic risk management and to consider disclosing against them, even where the data is incomplete or the models are imperfect, so long as sufficient assumptions and caveats are described so that the basis and scope of the disclosure can be transparently understood by the investor or the market.

WHAT ARE THE CAUSES OF ACTION/ REGULATORY RULES WHICH MIGHT BE RELIED ON BY CLAIMANTS IN BRINGING LITIGATION PROCEEDINGS AGAINST PREMIUM-LISTED ISSUERS?

Where investors have purchased securities in reliance on statements made by an issuer and have suffered a loss, they may seek to bring statutory or common law claims against the

relevant premium-listed issuer.
Such claims include allegations of false/misleading statements or omissions of material facts or dishonest delay in the publication of relevant information.
The losses that claimants are likely to rely on as a basis for their claims could include (amongst others) those arising from the disclosure/non-disclosure of information on:

- strategic risks (ie those looking at the big picture);
- quantitative risks (eg the inappropriate low valuation of assets, mischaracterisation of stranded assets or inaccurate risk-weighted assets (RWA) calculations which impact on capital ratios or give rise to capital adequacy concerns); and
- reputational risks (eg the mischaracterisation of climate profile leading to reputational damage and a loss of share price).

These claims can be brought on an individual basis but there is a growing trend for individual investors who have suffered financial losses to join in collective actions (similar to US style class actions) against the relevant issuer. The benefits of a collective action include the ability to share the financial risks of litigation and the rewards, if successful, across a wide group of investors. Ultimately, a collective action may be attractive as a method of levelling the litigation playing field between an issuer and its investors.

The primary statutory rules which investors may seek to rely on in bringing a claim against an issuer are s 90 FSMA and s 90A FSMA.

Section 90 FSMA provides that any person responsible (which includes issuers) for prospectuses or listing particulars can be liable to pay compensation to investors who acquired the securities (or any interest in securities) offered and suffered loss as a result of statements which are untrue or misleading. Issuers can also be liable if these documents fail to include information that is required by statute: ie the liability regime extends to omissions of information necessary to enable investors to make an informed assessment of the issuer and the rights attaching to the issuer's securities. There is no requirement for investors to prove that they relied on the alleged mis-statements or omissions.

Section 90A FSMA provides that an issuer can be liable to pay compensation to a person who has bought, sold, or holds securities in reliance on an untrue or misleading statement in, or omission from, information published by the issuer or the availability of which is announced by the issuer through a recognised information service (or by other means when the RIS is unavailable). An issuer can also be liable for dishonest delay in publishing information relating to its securities. However, a s 90A FSMA claim cannot be brought where there is a s 90 FSMA claim available. Also, an issuer will not be liable where the person discharging managerial responsibilities within the issuer can prove that they did not know or were not reckless as to whether the statement was untrue or misleading, or they did not know the omission was a dishonest concealment of a material fact.

The primary common law and equitable claims that investors may bring against an issuer include: fraudulent misrepresentation; negligent mis-statement; a statutory misrepresentation claim under the Misrepresentation Act 1967; breach of contract; mistake and claims in equity. The advantage of these claims is that they can be brought against both public and private companies, in contrast to claims under s 90 and s 90A FSMA which are only available against public companies.

We note that climate activists are increasingly using commercial litigation as a mechanism to promote their agenda (as demonstrated by the case brought by environmental group ClientEarth against Enea SA in relation to the construction of a coal-fired power plant in Poland). On this basis it is possible that activist minority shareholders could look to bring cases under s 90 or s 90A FSMA. However, given the need to prove a *prima facie* case of causation and loss, it is unlikely in the first instance. Such activists are more likely to agitate around non-compliance or industry disclosure standards where the hurdles of causation and loss (and reliance in the case of s 90A FSMA) are not required.

WHAT STEPS CAN UK PREMIUM-LISTED ISSUERS TAKE TO MITIGATE LITIGATION RISKS ARISING FROM THE PROPOSED REGULATORY CHANGE?

UK premium-listed issuers may wish to take note of the FCA's Consultation Paper and provide feedback to the FCA on any foreseeable issues arising out of the introduction of the new rule, which unreasonably increases their exposure to litigation risks.

Issuers may also wish to prepare for any changes to their disclosure obligations in relation to climate-related risks by, amongst other things, reviewing the adequacy of:

- existing due diligence processes or third party advisers in verifying climate-related information which is required to be disclosed; and
- assumptions and caveats in relation to climate-related disclosure (eg such as those for strategic, quantitative and reputational risks).

The FCA has noted that there are no mandatory requirements around verification or assurance given the evolving reporting practices amongst issuers. However, it would be prudent to ensure that such processes minimise the issuer's liability for climate-related disclosures.

Additionally, premium-listed issuers which fall within the financial services sector should consider the guidance issued by the Climate Financial Risk Forum (CFRF) in June 2020.[16] The CFRF represents a collaboration amongst industry professionals and is co-chaired by the FCA and the BoE to consider the sectoral and systemic issues arising from climate-related risks. The June 2020 guide is written for industry participants and includes examples of good practice for public climate-related disclosures to assist banks, insurers and asset managers in aligning their disclosures with the TCFD's recommendations. When looking

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ahead at next steps, the Deputy Governor for Prudential Regulation and CEO of the Prudential Regulation Authority (Sam Woods) directed industry towards the CFRF guide to meet the PRA's expectations in his Dear CEO letter of 1 July 2020.[17] The Executive Director for UK Deposit takers and Executive Sponsor of climate work for the BoE (Sarah Breeden) also endorsed the CFRF guide during its launch webinar on 29 June 2020, confirming her view that while the guide did not represent regulatory guidance it would help firms to meet regulatory expectations.

CONCLUSION

The FCA Consultation Paper is likely to be just the tip of the iceberg of climate-related disclosure guidance to come in the future. However, while investors may benefit from improved climate-related disclosure, there is a danger that issuers may face an increased risk of litigation given both the evolving nature of green finance and the increasing popularity of collective actions. Issuers may face claimants with a greater pool of resources at their disposal and who are willing to consider a full trial as a means to recovering their losses. Such actions also have the capacity to catch the attention of the media whose coverage can significantly affect the share price of an issuer's securities. Managing climate-related disclosures and the associated litigation risks will have to be given careful consideration and should become a regular feature on an issuer's agenda. ■

1 ShareAction, European Tracker: Shareholder resolutions on climate change: https://shareaction.org/fossil-fuels/resolutions-tracker/
2 TCFD Mission Statement.
3 Figures as at September 2020, TCFD Supporters: https://www.fsb-tcfd.org/tcfd-supporters/
4 Bank of England's climate related financial disclosure 2020 report.
5 Climate Risk Forum.
6 FCA Discussion Paper 18/8: Climate Change and Green Finance.
7 LR 7.2.3G.
8 LR 7.2.1A R.
9 LR 13.3.1R(1) and (3).
10 LR 1.3.3R.
11 Article 6.
12 Articles 7/14.
13 DTR 4.1.8 R; DTR 4.1.9 R; ss 414A to 414D CA 2006.
14 Article 17.
15 FCA Consultation Paper (CP20/3): Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations.
16 Climate Financial Risk Forum Guide: https://www.fca.org.uk/publication/corporate/climate-financial-risk-forum-guide-2020-summary.pdf
17 Letter from Sam Woods 'Managing climate-related financial risk - thematic feedback from the PRA's review of firms' SS3/19 plans and clarification of expectations': https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2020/managing-the-financial-risks-from-climate-change.pdf

Further Reading:

- Transition to hard law: ESG integration and the EU framework on sustainable finance (2020) 8 JIBFL 553.
- ESG factors in loan financing: moving the needle on sustainable finance (2019) 10 JIBFL 677.
- LexisPSL: Practice note: Environmental social governance – the investment market.