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Financial Conduct Authority
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Dear Federico,

CP20/3: Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations

1st October 2020

About the IoD

The IoD was founded in 1903 and obtained a Royal Charter in 1906. It is an independent, non-party political organisation of approximately 26,000 individual members. Its aim is to promote good governance and ensure high levels of skills and integrity among directors of organisations. The membership is drawn from right across the business spectrum, as well as the public and third sector. 49% of FTSE 100 companies and 45% of FTSE 350 companies have IoD members on their boards, but the majority of members, some 70%, comprise directors of small and medium-sized enterprises (SMEs), ranging from long-established businesses to start-up companies. IoD members' organisations are entrepreneurial and growth-orientated, and more than half (61%) export goods and services internationally.

General comments

The IoD welcomes the opportunity to participate in this consultation on proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations. Issues of this nature are of considerable interest to the IoD and its membership and we are therefore pleased to present our views in respect of your proposals.

When it comes to addressing the risks posed by climate change, Directors recognise the key role that their organisations must play. The Government has raised the bar by setting a challenging emissions target for the UK economy, but it can only be achieved if businesses respond, with boards setting a clear direction which is embedded throughout their organisations.

The work of the Task Force on Climate-related Financial Disclosures has resulted in a number of tools that are useful for directors in helping them to consider the impact of climate change on their organisations. Disclosures help boards to remain accountable to stakeholders, including but not limited to shareholders, as they also provide a useful framework around which board members can assess the impact of climate change on their business models and risk management.

While climate-related financial reporting is an area that is evolving quickly around the world, the TCFD recommendations have received widespread support internationally and are widely considered best practice. Against this background, we agree that the TCFD framework would be appropriate for the United Kingdom particularly if our regulation is to retain a national competitive advantage and adapt to meet the climate change challenge.

Notably, 70% of IoD members support companies moving to a common reporting standard on disclosures relating to climate change and environmental impact. Additionally, 75% of IoD members believe either some changes or significant reform to the UK's corporate governance framework is required to take greater account of climate change.

Scope of the new reporting requirements

We agree that applying this common disclosure framework to issuers with a premium listing may be appropriate in the first instance. However, in recent years there has been a material reduction in the number of companies seeking admission to the Premium Segment. Additionally, high-growth technology companies are materially under-represented on the Premium Segment. Notably, the largest UK initial public offering since 2015, The Hut Group's floatation saw the firm opt for the Standard Segment.

If this represents the beginning of a trend, there is a danger that the FCA's proposed scope may fail to capture significant entities. It should therefore seek to extend the reach of the disclosure requirements to all UK-listed companies within a reasonable period of time.

We agree that sovereign-controlled commercial companies with a premium listing should be within scope. If this category is to continue to exist, we see no justification for why listing rules relating to premium category issuers should be waived or removed in cases where the issuer has a controlling sovereign shareholder. If anything, we believe that listing rules should be strengthened for this category of issuer given its distinctive governance challenges and risks.

Consistency with global standards

We agree that referencing TCFD's recommendations in their entirety will help maintain coherence and consistency. Additionally, making explicit reference in Handbook guidance to the TCFD's guidance for all sectors as well as supplemental guidance will help support effective disclosures. Providing additional direction which references a wider set of materials will support issuers.

One of the challenges facing directors is the increasing fragmentation of the regulatory landscape. In order for board members to gain an appropriate overview, it is useful to have key governance regulations summarised in one place even if they are replicated in other regulatory frameworks.

Proportionality

We do not believe that the new disclosure rules should only be introduced on a 'comply or explain' basis. For reasons of comparability and consistency, we believe that disclosures of this kind should be made in the context of a standardised and common framework – on a similar basis to other financial reporting requirements.

Through the UK Corporate Governance Code, the concept of 'comply or explain' the UK has successfully promoted high standards of corporate governance over many years by preserving a welcome degree of flexibility for individual firms in adhering to high level governance principles. However, climate change reporting is a qualitatively different in nature to the governance best practices advocated in the Code (e.g. concerning board structure and processes).

For climate change reporting, there needs to be a common benchmark which allows climate change risks and impacts to be assessed on a consistent and comparable basis – allowing financial markets to manage and price these climate-related risks and opportunities appropriately. In any case, TCFD recommendations are a principles-based framework, which already provide some degree of flexibility for issuers to disclose in a proportionate way.

Efficient financial reporting is essential for monitoring executive management as well as evaluating the financial consequences of strategic decisions. Applying the TCFD recommendations will help facilitate comparable and consistent disclosures that companies can use to demonstrate climate change resilience to stakeholders including shareholders and lenders.

Finally, the decision to opt for reporting on a 'comply or explain' basis would be insufficiently robust given the UK Government expects all listed companies and large asset owners to disclose in line with the TCFD recommendations by 2022. Determined action is needed straight away in order to attain this objective.

Materiality assessment for governance and risk management disclosures

We believe that TCFD's focus on governance should help build internal momentum and support the wider integration of climate-related issues into strategic considerations. Disclosures regarding the board's consideration of these issues, including relevant risks and opportunities, are often qualitative we therefore do not believe that they should be subject to a materiality assessment (e.g. based on purely financial metrics or thresholds).

The board of a company is well-placed to prioritise the relative importance of climate-related risks, and to disclose the way in which risks and opportunities are being monitored and managed by the board. What constitutes financial materiality varies by industry sector and many business activities may not pass financial materiality thresholds while nonetheless having significant implications for climate impact or corporate reputation.

Location of disclosures, assurance and statement of compliance

We agree that the statement of compliance and proposed disclosures should be made within the issuer's annual financial report. We hope that such reporting can be incorporated into companies' annual reports in a cohesive way that avoids unnecessary repetition.

Assurance

We agree that the FCA should not initially require third- party assurance of issuers' climate-related disclosures, although this should be developed over time. Robust assurance in this area is likely to require further necessary development of standards on assurance and consideration of how best to ensure auditors and other assurance providers have the necessary knowledge and expertise on relevant matters related to sustainability. At present, we do not perceive that this capability is available – and we do not want the lack of current assurance capability to delay the speedy introduction of meaningful reporting on climate change. The governance processes for these disclosures will be similar to those for existing public disclosures requiring board approval with the chief financial officer and audit committee playing a role, as appropriate.

Application of established concepts and principles

Consideration should be given to interaction between the proposed rule and the UK Corporate Governance Code as well as the Financial Reporting Council's Guidance on Audit Committees and Guidance on Risk Management, Internal Control and Related Financial and Business Reporting. Notably, Provision 1 of the Code requires the board to describe in its annual report "how opportunities and risks to the future success of the business have been considered and addressed".

Other observations

It is important that there is sufficient guidance, education and support for boards to ensure they are in a position to make meaningful disclosure under a new reporting regime. There may also be opportunities for government assistance in reducing the cost of disclosure, for example by producing common sets of assumptions (e.g. the future price of carbon) that could be used to help reduce the cost of forecasting or specialist modelling that each organisation may otherwise be required to produce.

We hope you have found our comments helpful. If you require further information about our views, please do not hesitate to contact us.

With kind regards,

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