FCA Climate Change and Green Finance Discussion Paper DP18/8

CDSB and CDP joint consultation response – 31 January 2019

The Climate Disclosure Standards Board (CDSB) and CDP welcome the opportunity to respond to the October 2018 Financial Conduct Authority (**FCA**) discussion paper on the Climate Change and Green Finance DP18/8 (the **Discussion Paper**)[1].

CDSB is an international consortium of nine business and environmental NGOs. CDSB is committed to advancing and aligning the global mainstream corporate reporting model to equate natural capital with financial capital. CDSB does this by offering companies a framework for reporting environmental and climate information (the **CDSB Framework**) with the same rigour as financial information. In turn, this helps companies to provide investors with decision-useful environmental and climate information via the mainstream corporate report, enhancing the efficient allocation of capital. Regulators also benefit from compliance-ready materials. Recognising that information about natural capital and financial capital is equally essential for an understanding of corporate performance, CDSB's work builds the trust and transparency needed to foster resilient capital markets.

CDP is a global environmental impact non-profit working to secure a thriving economy that works for people and planet. High quality, relevant information is the fundamental basis for action and CDP helps investors, companies and cities to measure, understand and address their environmental impact. The world's economy looks to CDP as the gold standard of environmental reporting with the richest and most comprehensive dataset on corporate and city action. CDP aims to make environmental reporting mainstream and provide the detailed insights and analysis to drive the urgent action needed for a climate safe, water secure, deforestation free world. CDP recognises the important role of the Task Force on Climate-related Financial Disclosures (TCFD) in mainstreaming climate-related information and advancing the availability of financially relevant information for global markets. Therefore, CDP has aligned its information requests with the TCFD recommendations, alongside introducing a sectoral focus and adopting a forward-looking approach to climate risk disclosure.

Collectively, CDP and CDSB aim to contribute to more sustainable economic, social and environmental systems. CDP and CDSB are also members of the UK's Green Finance Initiative (GFI) working group on Data, Disclosure and Risk. CDP and CDSB co-lead the GFI's response to this consultation so there may be similar recommendations and views expressed in that response as you see in this document. Our shared response also incorporates relevant elements of ClientEarth's response. We expand on many of our comments in this document in our response to the PRA Consultation Paper 23/18: Enhancing banks' and insurers' approaches to managing the financial risks from climate change, please find this attached.

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Kind regards,

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[1] Financial Conduct Authority (2018) Climate Change and Green Finance DP18/8. [PDF]. Available from: https://www.fca.org.uk/publication/discussion/dp18-08.pdf

Disclosures in capital markets

Q1: What, if any, difficulties do issuers face in determining materiality? We are also interested in exploring how investors consider materiality in this context.

In the context of financial statements, auditors set the materiality for the financial statements as a whole at the planning stage (we note however that ultimate responsibility for the content of financial statements lies with the directors). This is expressed as a level (usually a percentage) of an appropriate quantitative benchmark. This benchmarking approach is challenging in the context of qualitative information, such as that included in the strategic report or non-financial statement (as required by the Companies Act 2006), management report (as required by various provisions of the Listing Rules and Disclosure Guidance and Transparency Rules), listing particulars (as required by the Prospectus Rules), etc. While this qualitative information is materially significant, it is not expressed numerically. Auditors and directors are also required to consider the nature of an item, not just the size. Therefore, an item that is not quantitatively material, can still be qualitatively material, i.e. material by nature. This assessment can pose challenges. Nevertheless, the *concept* of materiality is used in regulatory guidance about how to determine what information should be included in any of these reports.

For example, the FRC's *Guidance on the Strategic Report*[2] states:
'Information is material if its omission or misrepresentation could reasonably be expected to influence the economic decisions shareholders take on the basis of the annual report as a whole. Only information that is material in the context of the strategic report should be included within it.' (Paragraph 5.1, see also Paragraphs 5.2–5.4.)

This challenge is compounded by the fact that the purpose of the strategic report is to inform shareholders how the directors have performed their duty under s.172 of the Companies Act 2006 to promote the success of the company. This is a subjective duty.

Moreover, issuers face difficulties relating to the specific nature of climate risks and opportunities, including, among others:

- Limited knowledge of climate-related issues within organisations;
- Preconceptions about the nature of climate change which lead to an initial bias in the assessment of climate risk;
- The tendency to focus mainly on near-term risks with inadequate attention paid to potential long-term risks. The time horizon over which financial risks from climate change may be realised are uncertain, and their full impact may occur outside many business planning horizons; and
- Difficulties translating and equating climate risk with financial risks and/or opportunities.

The "materiality filter" applies to certain TCFD recommendations and not to *Governance* and *Risk Management*. As climate-related risk is a non-diversifiable risk that affects nearly all sectors, many investors believe it requires special attention. In assessing organisations' financial and operating results, many investors seek insights into the governance and risk management context in which such results are achieved.[3]

The issue of materiality plays out in a unique way in relation to scenario analysis. The TCFD recommends that where management deems it material, it should describe 'the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.' A question arises as to how can organisations assess the materiality of different climate-related scenarios without conducting scenario analysis? We interpret this materiality threshold as applying to the disclosure of the outcomes of scenario analysis. Where an organisation does not disclose information related to scenario analysis, investors could infer that management is not using scenario analysis to assess climate risks, even if the company has conducted such analysis.

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[2] FRC, 2018. Guidance on the Strategic Report. [Online]. Available at: https://www.frc.org.uk/getattachment/fb05dd7b-c76c-424e-9daf-4293c9fa2d6a/Guidance-on-the-Strategic-Report-31-7-18.pdf
[3] Task Force on Climate-related Financial Disclosures, 2017. Final Report - Recommendations on the Task Force on Climate-related Financial Disclosures. [Online]. Available at: https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf, p.33.

For corporate boards disinclined to consider potential climate-related financial impacts, a lack of material significance can be cited as the rationale for non-disclosure. This is of concern, given the Sustainability Accounting Standards Board's Technical Bulletin's finding that climate change is likely to have material financial impacts on companies in 72 out of 79 industries, representing 93% of the U.S. equity market, or US$27.5 trillion.[4] As a non-diversifiable risk that affects nearly all industries, the Financial Stability Board and many investors believe climate change merits special attention.

In light of these issues, consulting on guidance to issuers by the FCA about how the current regulatory regime might be interpreted to apply to climate change-related risks is useful but not sufficient. Requiring TCFD disclosures would greatly assist in addressing the problems caused by the misapplication of materiality to the unique financial risks posed by climate change. FCA action on this issue is in accordance with its mandate and strategic objectives to ensure that relevant markets function well, as well as the operational objectives of protecting consumers, improving market integrity and advancing competition.

CDSB has considered the established treatment of materiality in the context of the TCFD in a discussion paper[5], which may provide useful guidance for the FCA to draw upon.

We also recognise that enhanced guidance in this area will need to be combined with effective enforcement by the FCA to ensure it is implemented in practice.

Q2: We are interested in understanding whether greater comparability of disclosures would help investors in their decision-making more generally

Yes, greater consistency and comparability of disclosures would help investors in their decision-making.

In addition, the Green Finance Taskforce's report to the government (the **GFT Report**) points out that "the current lack of consistent and comparable data is a barrier to realising more green finance opportunities in the UK and globally. It can prevent investors from managing risks as well as seizing opportunities that climate change presents"[6].

CDSB has long identified the need for more consistent and comparable disclosures and consistency of underlying assumptions used to prepare disclosures (e.g.: scenarios used for scenario analysis). This includes the need for "coalescence around standards, protocols and approaches that are already widely adopted for the purposes of preparing corporate reports;" coupled with the need for "Eliminating duplicate requirements and avoiding adding new requirements where it is possible to consolidate existing requirements and practices".[7] To this end, the **Corporate Reporting Dialogue** (http://corporatereportingdialogue.com/) has launched the "Better Alignment Project", which brings together the key global standard setters and framework developers which have a significant international influence on the corporate reporting landscape. The project is focused on driving better alignment in the corporate reporting landscape, to make it easier for companies to prepare effective and coherent climate-related financial disclosures that meet the information needs of capital markets and society. The findings of this project will contribute to greater consistency and comparability of such disclosures globally.

Q2b: What framework would be most useful in greater comparability of disclosures to help investors in their decision-making?

The TCFD's 11 recommended disclosures and underlying principles would be the most useful, universally and internationally accepted framework to promote greater comparability of disclosures and aid investors in their decision-making and capital allocations. Implementing the TCFD recommendations can deliver the quality of

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[4] SASB, 2018. Climate Risk - Technical Bulletin. [Online]. Available at: https://library.sasb.org/climate-risktechnical-bulletin/

[5] Climate Disclosure Standards Board (2018) Position paper: Materiality and climate-related financial disclosures. [PDF]. Available from: https://www.cdsb.net/sites/default/files/materiality_and_tcfd_paper.pdf

[6] Green Finance Taskforce (2018) A report to Government by the Green Finance Taskforce. [PDF]. Available from: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/703816/green-finance-taskforce-accelerating-green-finance-report.pdf

[7] Climate Disclosure Standards Board (2012) The case for consistency in corporate climate change-related reporting, Page 18. [PDF]. Available from: https://www.cdsb.net/sites/cdsbnet/files/the-case-for-consistency-in-climate-change-related-reporting.pdf

climate-related financial information that investors need for decision-making and the exposure to climate risk can be assessed, reduced and managed by companies.

The annual CDP climate change questionnaire[8] has been fully aligned with the TCFD recommendations and can help companies collect and structure the content needed for disclosures. Using CDP's disclosure system guarantees the comparability and standardisation of disclosures, produces insights for companies that go well beyond minimum standards, and ensures reported data is delivered to all relevant stakeholders and fed directly as a global standard into financial markets and products. To implement the TCFD recommendations, issuers can then use the CDSB Framework[9] to elicit material climate-related financial information and embed it in the annual (Director's or Strategic) report. The principles and requirements of the CDSB Framework are directly aligned with those of the TCFD.

Q3: Would exploring a 'comply or explain' approach, or other avenues to encourage more consistent disclosures, be an effective way of facilitating more effective markets?

If the aim is to bring more consistent and comparable disclosures to the market, then a comply or explain approach is not the most effective mechanism for achieving this. The most effective mechanism would be mandatory disclosure of climate-related financial information. There are already existing laws in place which require the disclosure of material information which are applicable to the disclosure of climate-related information. As stated above, this must also be viewed in the context of ensuring that these existing mechanisms are enforced. Moreover, requiring adoption of the TCFD recommendations by regulated firms as a framework for disclosing climate change-related information under their existing disclosure obligations would prove beneficial to support more consistent and comparable climate disclosures.

We recognise the benefit of a 'comply or explain' approach in providing flexibility for report preparers and thus potentially reducing their reporting burden. We note that the TCFD recommendations incorporate the principle of materiality, which provides an entity-specific lens on what information should be included or omitted from a report. In contrast, if there is an option to explain why information has not been provided, then this enables an issuer to not report said information.

Conversely, an entity can determine that a particular TCFD recommendation is not material and remain silent on the topic. Under the 'explain' approach, investors would at least obtain an insight into why the company has not provided such information.

The October 2018 Intergovernmental Panel on Climate Change (IPCC) special report[10] stated that there are only 12 years left to limit warming to 1.5°C above pre-industrial levels, thus minimising dangerous climate change impacts. The TCFD acknowledges in its Final Report that it will take 5 years for mainstream adoption of its recommendations. Better reporting of climate-related financial matters is necessary but is only a first step to tackle this climate challenge. Following the availability of effective disclosures, action must be taken by market participants and regulators, like the FCA, to respond the information provided in these disclosures. It is therefore inadequate to implement partial and inconsistent reporting under a 'comply or explain' approach and rapid uptake of the 11 TCFD recommended disclosures is therefore needed.

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[8] CDP (2018) Disclosure in 2019. [Online]. Available from: https://www.cdp.net/en/companies-discloser/disclosure-info, and see also CDO (2018) CDP Technical Note on the TCFD: Disclosing in line with the TCFD's Recommendations. [PDF]. https://b8f65cb373b1b7b15feb-c70d8ead6ced550b4d987d7c03fcdd1d.ssl.cf3.rackcdn.com/cms/guidance_docs/pdfs/000/001/429/original/CDP-TCFD-technical-note.pdf?1512736184

[9] Climate Disclosure Standards Board (2017) CDSB Framework for reporting environmental information, natural capital and associated business impacts. [PDF]. Available from: https://cdsb.net/Framework

[10] Intergovernmental Panel on Climate Change (2018) Summary for Policymakers. In: Global Warming of 1.5 °C - an IPCC special report on the impacts of global warming of 1.5 °C above pre-industrial levels and related greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty. [PDF]. Available from: https://www.ipcc.ch/site/assets/uploads/sites/2/2018/07/SR15_SPM_High_Res.pdf

Public reporting requirements

Q1: Do you think that a requirement for firms to report on climate risks would be a valuable measure?

We note in paragraph 5.24 of the Discussion Paper that the FCA is considering "introducing a new requirement for financial services firms to report publicly on how they manage climate risks to their customers and operations". We concur that this would be valuable.

The need for this approach is supported in paragraph 3.5 of the Discussion Paper "…the expected transition to a low carbon economy is likely to have a significant impact on our economy, so it is important that the UK's financial markets can both respond to and support the transition in a stable and orderly way", and "…the adequate disclosures of material risks and opportunities, including those which are climate change-related, are essential for a transparent and efficient price formation process".

Financial sector firms' exposure to climate risk is mostly located in their investments. Existing disclosure requirements do not take this into account and for the most part require firms to report predominantly on their operations only.

This new requirement would be most effective if such disclosures were to be made through the vehicle of the mainstream report (e.g. the Annual Report, Prospectus, and/or other mandatory reporting documents), which is also consistent with that advocated by the TCFD.

Q2: Do you have any suggestions for what information could be included in a climate risks report?

The FCA should provide further details on what they mean by a climate risks report. It is unclear in the Discussion Paper whether the FCA is proposing a separate report or whether this could form part of Annual Report, Prospectus, and/or other existing reporting mechanisms. Please see our comment in Q1 above.

In terms of substantive content of the climate risks report, it should cover the 11 recommended disclosures (including the strategy disclosures related to scenario analysis where material) and adhere to the advice in the TCFD Supplemental Guidance for the Financial Sector[11]. Additionally, we note that the EU Technical Expert Group on Sustainable Finance's report on climate-related disclosures[12] was released earlier this month. It outlines the potential benefits of climate-related disclosures to listed companies, banks and insurance undertakings, and provides specific KPIs for climate disclosure in these sectors. FCA should align its reporting requirements to this work.

Given the nature of firms under the FCA's authority, it is important to emphasise the need to consider climate risk exposure of these organisations through their investments. While many businesses have material climate risk exposures within their own operations, much of this risk lies outside the financial boundary of financial institutions.

Q3. Do you have any views on which regulated firms should be required to compile a climate risks report?

All regulated firms should prepare a climate-related risks report and integrate such reporting into their existing mainstream reports.

We do not support a sectoral approach on whether or not an entity should be required to compile a climate risks report. Albeit to varying degrees, all firms under the FCA's authority are potentially exposed to climate risks, principally through their investments and should therefore consider these. We note however that some differentiation in the type of reported information may be needed based on the sector of an entity. If the FCA is

[11] See section D, Task Force on Climate-Related Financial Disclosures (2017) Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures. [PDF]. Available from: https://www.fsb-tcfd.org/wp-content/uploads/2017/12/FINAL-TCFD-Annex-Amended-121517.pdf

[12] European Commission (2018) Sustainable Finance TEG Report Climate Relate Disclosures. [PDF]. Available from: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190110-sustainable-finance-teg-report-climate-related-disclosures_en.pdf

concerned that immaterial information could be reported, we note that the TCFD's emphasis on materiality would function to filter this out.

The alternative suggested in the Discussion Paper is based on the size of regulated firms. While the largest firms may be systemically important, the aggregate exposure of smaller firms may also be significant. It is also important to take into account the relative capacities of the smaller firms, with perhaps less onerous reporting requirements set out for them.

We would also like to highlight that the financial reporting requirements and practices for financial services firms can vary widely. Some firms do not report publicly, while others make more extensive disclosures if they have public debt or equity. The TCFD states that asset managers and asset owners (for example) should use their existing means of financial reporting to their clients and beneficiaries where relevant and feasible.

Additional questions

Q1: How can authorities, including the FCA, most effectively work with industry to meet investor demand for green investment opportunities and encourage those raising capital and investing in it to pursue sustainable outcomes?

A public statement by the FCA setting out its approach to regulatory oversight of climate-related financial disclosures would act as a clear signal to industry and markets. This could help support investor demand for green investment opportunities.

The TCFD recommendations state that "the more adoption increases, the more transparent the markets will become, the more secure and stable the economy will be, and the faster we can make progress against the harmful effects of climate change." As a regulator of financial markets, the FCA could do more to promote awareness of the TCFD recommendations to increase adoption and implementation. Research commissioned by HSBC[13] suggests that while ESG investment is now mainstream with 61% of investors and 48% of companies having an ESG strategy in place, only 10% of investors and 8% of companies are aware of the TCFD.

The FCA could conduct annual industry research and analysis including reviews of disclosures by companies, to consider how industries are responding to investor demand for green investment opportunities. The following two papers released by the PRA that consider the impacts of climate change on financial services firms could be used as examples:

- The impact of climate change on the UK insurance sector (A Climate Change Adaptation Report by the Prudential Regulation Authority) (September 2015)[14]
- Transition in thinking: The impact of climate change on the UK banking sector (September 2018)[15]

Q2: Do you agree with the extent of the FCA's proposed interventions on climate change-related financial disclosures? Is there a specific need for us to intervene further in the interests of market integrity or consumer interests?

We welcome the steps proposed in the Discussion Paper. There are further steps the FCA should take to meet its objectives around market integrity, competition, as well as consumer protection and interests. For example, the FCA should extend its focus to the information required in relation to the listing process.

We would also draw your attention to the fact that financial regulators are being asked to report under the third round of Defra's adaptation reporting power. We suggest this mechanism could also be a useful way of furthering the above objectives.

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[13] HSBC (2018) News Release - ESG Moves Mainstream. [PDF]. Available from: https://www.hsbc.com/media/media-releases/2018/esg-moves-mainstream

[14] Bank of England (2018) Impact of Climate Change on the UK Insurance Sector. [PDF]. Available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/publication/impact-of-climate-change-on-the-uk-insurance-sector.pdf

[15] Bank of England (2018) Impact of Climate Change on the UK Banking Sector. [PDF]. Available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/report/transition-in-thinking-the-impact-of-climate-change-on-the-uk-banking-sector.pdf?la=en&hash=A0C99529978C94AC8E1C6B4CE1EECD8C05CBF40D

We also note that the Discussion Paper does not cover what enforcement action the FCA will take if its supervisory expectations are not met. These should be clearly stated.

Q3: In light of the EU work on taxonomy, what are your views on the form common standards and metrics for measuring and reporting against green financial services products should take?

We welcome the ongoing work of the Technical Expert Group (TEG) subgroup on taxonomy; however, until the details of the taxonomy are finalised, it is difficult for us to comment. We advise the FCA to revisit this question once the EU taxonomy is published. This TEG subgroup has published a progress report[16], and the European Commission's consultation[17] on the usability of the EU taxonomy closes on 22 February 2019.

Alignment of financial services regulation in a post-Brexit context will be an important issue to consider.

Q4: How could regulators and industry best work together as part of the Climate Financial Risk Forum?

We welcome the establishment of the Climate Financial Risk Forum. Both CDSB and CDP have a proven track record and a wealth of relevant experience of over 10 years to bring to the Forum. We would like to explore ways in which we could contribute to the work of the Climate Financial Risk Forum.

We suggest that, given the pre-eminent importance of climate risk to the UK economy as outlined in the Discussion Paper, the Climate Financial Risk Forum could invite the Pensions Regulator and the Financial Reporting Council as members, if it has not done so already. This will ensure a joined-up approach across the four financial regulators for overseeing climate-related financial risks and avoid duplication. A further mechanism to formalise collaboration on climate risk between the four regulators could be through signing of a Memorandum of Understanding, outlining the different roles and responsibilities of each regulator and actions they will take concerning climate-related financial risk.

The Green Finance Initiative, in partnership with CDP, CDSB and PRI has convened industry and experts in November 2018 under the UK TCFD Preparers Forum to share experiences on implementing the TCFD recommendations. Plans are underway for similar forums in 2019, and as members of the GFI, we invite the FCA to participate in these. The Climate Financial Risk Forum may also wish to co-host such events with the GFI.

Regulators, through the Climate Financial Risk Forum, could support preparers of climate-related financial disclosures and convene businesses and organisations from the financial sector together to exchange good practices in implementing and using the TCFD's recommendations. The FRC Reporting Lab is also undertaking a project on climate risk disclosure. We encourage the FCA to actively engage of this project, including sharing outcomes of this consultation with the project group.

Q5: What are your biggest concerns and commercial priorities regarding climate change?

Our biggest concern is that the market will not move at the pace required to limit dangerous climate change and its impacts on the UK's economy by 2030. The IPCC special report[18] presented a stark message on the importance of limiting global temperature rises to 1.5 degrees. The significance and scale of this challenge will require timely action by both the public and the private sector.

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[16] Technical Expert Group on Sustainable Finance Subgroup (2018) Taxonomy Progress Report. [PDF]. https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-teg-subgroup-taxonomy-progress-report_en.pdf

[17] European Commission (2019) Feedback on the usability of the taxonomy. [Online]. Available from: https://ec.europa.eu/eusurvey/runner/taxonomy-feedback-usability

[18] Intergovernmental Panel on Climate Change (2018) Summary for Policymakers. In: Global Warming of 1.5 °C - an IPCC special report on the impacts of global warming of 1.5 °C above pre-industrial levels and related greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty. [PDF]. Available from: https://www.ipcc.ch/site/assets/uploads/sites/2/2018/07/SR15_SPM_High_Res.pdf

Interventions by regulators and market participants are urgently needed to ensure resilience of the financial system. CDSB and CDP have supported the market to improve the quantity and quality of climate and environmental reporting significantly, but mandatory disclosure of climate-related financial risks by FCA-regulated firms is essential to meet this challenge at the pace and scale required.

Q6: What are the biggest barriers to the growth of green financial services in the UK?

We draw the FCA's attention to the findings of the GFT Report[13] which highlights significant barriers to accelerating green finance in the UK, such as the following:

- "Lack of consistent and comparable data is a barrier to realising more green finance opportunities in the UK and globally. It can prevent investors from managing risks as well as seizing opportunities that climate change presents." (page 22)
- "Without credible comparability of climate related disclosures, which are most reliably based on a level playing field of disclosure requirements, it is difficult for financial system users and beneficiaries to trust the information they receive." (page 36)
- "Despite wide acceptance in business and finance of the need to reduce emissions, information failures limit understanding of the financial risks and opportunities and hamper decision making." (*ibid*)
- Lack of forward-looking analysis (*ibid*);
- Inadequate consideration of transition risks (*ibid*); and
- Partial enforcement of existing requirements (*ibid*).