WHILE US PUBLIC COMPANIES AWAIT SEC RULEMAKING, THE UK CONTINUES TO MOVE FORWARD WITH MANDATORY TCFD-ALIGNED DISCLOSURE REQUIREMENTS

In late October, just ahead of COP26, the UK government announced plans to introduce legislation mandating climate-related disclosures by large companies and financial institutions. The legislation is expected to be enacted by Parliament in April 2022. The mandated disclosures would be in line with the recommendations of the Task Force on Climate-related Financial Disclosures ("TCFD") and would represent the first such mandatory requirements among the G20 countries as well as a key component of the UK government's goal of creating the world's first Net Zero-aligned Financial Centre. As a result of Brexit, the UK government is able to move forward on a track separate and apart from EU efforts that cover similar requirements.

The proposed legislation follows the pledge made in November 2020 by UK Chancellor of the Exchequer Rishi Sunak that the United Kingdom would be the first to enact mandatory climate-related disclosures. That announcement also covered a new green taxonomy and plans for the first UK sovereign green bond. Mandatory TCFD-aligned requirements would go beyond the traditional "comply or explain" approach that is central to traditional UK corporate governance requirements.

In mid-October, the UK government published a report Greening Finance: A Roadmap to Sustainable Investing, setting forth the goal of implementing Sustainable Disclosure Requirements ("SDRs") for businesses and asset managers. These efforts flow from the Green Finance Strategy, announced by the UK government in 2019.

Concurrently with the late October announcement of the new disclosure requirements, the UK government also announced its Net Zero Strategy, and issued its Net Zero Strategy: Build Back Greener and an accompanying analysis of key issues relating to the Net Zero strategy.

These initiatives are part of the UK government's overarching efforts to accelerate the transition to a sustainable economy, create green jobs and support the government's environmental goals, including achieving net zero emissions by 2050.

SDRs

The SDRs would apply to over 1,300 of the largest UK-registered companies and financial institutions (banks and insurance companies). These companies would be either listed companies or private companies with over £500 million in revenues and more than 500 employees.[1] The new requirements largely track the proposals that were subject to UK government consultation, with two modifications: mandatory disclosure would also include

[1] As a technical matter, the following entities are in scope:

- All UK companies that are currently required to produce a non-financial information statement, being UK companies that have more than 500 employees and have either transferable securities admitted to trading on a UK regulated market, or are banking companies or insurance companies (Relevant Public Interest Entities);
- UK registered companies with securities admitted to AIM with more than 500 employees;
- UK registered companies which are not included in the categories above, which have more than 500 employees and a turnover of more than £500m.
- LLPs which have more than 500 employees and a turnover of more than £500m.

qualitative scenario analysis[2] and would be more closely aligned with the TCFD recommendations than initially envisaged. The SDR regime contemplates that:

- reporting companies, including in the financial sector, would likely report under the International Sustainability Standards Board (ISSB) reporting standards (based on a proposed mechanism for the United Kingdom to adopt and endorse the ISSB standards);
- asset owners and asset managers would disclose how they take sustainability into account; and
- creators of investment products would report on the sustainability impact of their products and the relevant financial risks and opportunities.

The current timetable provides for corporate reporting under the SDRs within two years of enactment (royal assent). The other requirements would be effective shortly thereafter.

The UK Financial Conduct Authority ("FCA") had already called on UK commercial companies listed under Chapter 14 of the UK Listing Rules (wherever headquartered or incorporated) to provide climate-related disclosure in their annual reports based on the TCFD recommendations. Disclosure is subject to an enhanced "comply or explain" principle[3] and applies to annual reports for financial years beginning on or after January 1, 2021, which would be published in early 2023 (or, in the case of Chapter 14 companies with standard listings, beginning on or after January 1, 2022). (See Primary Market Bulletin 36 and Primary Market Technical Note, as well as the FCA's ESG Strategy paper issued in November.)

Transition Plans

The Net Zero-aligned Financial Centre initiatives will require asset managers, regulated asset owners and listed companies to publish on a "comply or explain" basis transition plans that take into account the UK government's new zero commitments, or provide an explanation if they have not done so. As standards for transition plans emerge, they will be incorporated into the SDRs. The transition plans would set out:

- high-level targets that the relevant company is using to mitigate climate risk, including targets for reduction of GHG emissions (*i.e.*, a net zero commitment);
- interim milestones; and
- actional able steps to achieve those targets.

These transition plans are consistent with the call to action issued by the Glasgow Financial Alliance for Net Zero (GFANZ).

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2 The required analysis will be of the resilience of the reporting company's business model and strategy, taking into account different climate-related scenarios. In associated guidance, the government will make clear that qualitative assessments of resilience against different scenarios will suffice.

3 The "enhanced" aspect of the "comply or explain" principle in the context of climate disclosures is enshrined in the applicable Listing Rule (9.8.6R(8)), which provides that the FCA would "normally expect a listed company to be able to make" TCFD-consistent disclosures (particularly around governance and risk management), except where the listed company "faces transitional challenges in obtaining relevant data or embedding relevant modelling or analytical capabilities."

Green Taxonomy

The UK has reaffirmed its commitment to create its own version of the EU taxonomy framework, a framework that will set out which investments can be defined as environmentally sustainable and, in effect, reduce the incidence of greenwashing in the investment arena. The work will be undertaken by the Green Taxonomy Advisory Group (GTAG). It is expected that given the importance of international alignment, that the UK will not diverge significantly from EU standards.

Concluding Thoughts

While many have been calling for mandatory corporate disclosure regimes for some time, the tide is turning. These regimes will be in place shortly (and some mandatory elements in effect already are in place) in the United Kingdom and in place shortly in the European Union. The United States is likely to join the bandwagon, although given the absence of a formal roadmap that accompanied UK and EU efforts), it is impossible to predict what the scope of new rulemaking may be. The key will be for regulators to learn from early missteps and to align as closely as they can with one another. We have seen the dysfunction created by the plethora of inconsistent, voluntary standards out there today.

Public companies that have yet to consider the implications of mandatory disclosure standards should be focused on the potential contours of such a regime (the TCFD recommendations are a good place to start) and the extensive data collection effort to meet any likely disclosure requirements.

Related Resources

Climate lexicon https://bit.ly/3DUIDsk

ESG board oversight https://bit.ly/3ob5NVY

The launch of the ISSB https://bit.ly/31xXiLw

Climate change by the numbers https://bit.ly/3bt4Ilb

Climate change and US financial stability https://bit.ly/3kiD2nX

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Washington, D.C.
December 6, 2021