New Climate-Related Financial Disclosures for Private Companies and LLPs

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Editor's note: Gareth Rees and Matthew Dunlap are partners and Stephanie Pong is an associate at Morrison & Foerster. This post is based on a Morrison & Foerster memorandum by Mr. Rees, Mr. Dunlap, Ms. Pong, and James Quirke.

Related research from the Program on Corporate Governance includes The Illusory Promise of Stakeholder Governance (discussed on the Forum here) and Will Corporations Deliver Value to All Stakeholders? (discussed on the Forum here), both by Lucian A. Bebchuk and Roberto Tallarita; Restoration: The Role Stakeholder Governance Must Play in Recreating a Fair and Sustainable American Economy—A Reply to Professor Rock by Leo E. Strine, Jr. (discussed on the Forum here); and Stakeholder Capitalism in the Time of COVID, by Lucian A. Bebchuk, Kobi Kastiel, and Roberto Tallarita (discussed on the Forum here).

Companies and limited liability partnerships (LLPs) "with the greatest economic and environmental impact" are now subject to the legal requirement to assess their climate risks and disclose climate-related financial information as a result of new regulations which came into force on 6 April 2022. This follows the Financial Conduct Authority (FCA) extending climate-related financial disclosure obligations to, among others, standard-listed companies and certain asset managers and owners in December 2021, as discussed in our previous client alert.

Under the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 and Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022 (the "Regulations"), certain companies and LLPs—including large private companies—are now obliged to make disclosures of climate-related financial information for accounting periods beginning on or after 6 April 2022.

Companies within scope of the FCA's Listing Rules will now be subject to two frameworks, and UK government guidance has confirmed disclosures required under the Listing Rules should also be compliant with the new Regulations.

Which companies do the Regulations apply to?

The new climate-related financial disclosure obligations now apply to the following entities where their accounting periods start on or after 6 April 2022:

- **UK Registered Companies** which include:
    - Publicly quoted companies with (i) more than 500 employees and (ii) transferable securities trading on a UK regulated market or AIM;

    - Private limited companies with (i) more than 500 employees and (ii) a turnover of more than £500 million; and
    - Relevant public interest entities such as insurance or banking companies with more than 500 employees.

In-scope companies are required to include their disclosures in the non-financial and sustainability information statement in their strategic report. For group companies, disclosures should be made in the consolidated group report of the parent company. Where the parent does not produce consolidated accounts, the scope criteria are applied to the aggregate turnover and employee figures for the group. The parent is then required to make disclosures relating to itself, including how climate-related risks and opportunities may affect the value of its investments in its subsidiaries.

- **Limited Liability Partnerships** which include:
    - Traded or banking LLPs with more than 500 employees; and
    - LLPs which (i) are not traded or banking LLPs, (ii) have more than 500 employees, and (iii) have a turnover of more than £500 million.

In-scope LLPs should include their disclosures in the energy and carbon report of their directors' report or, if applicable, their strategic report.

New Climate-Related Financial Disclosure Obligations

In-scope companies and LLPs are required to make climate-related financial disclosures against a list of common requirements:

a. A description of the entity's governance arrangements in relation to assessing and managing climate-related risks and opportunities (CROs);
b. A description of how the entity identifies, assesses, and manages CROs;
c. A description of how processes for identifying, assessing, and managing climate-related risks are integrated into the entity's overall risk management process;
d. A description of: (i) the principal CROs arising in connection with the company's operations; and (ii) the time periods by reference to which those risks and opportunities are assessed;
e. A description of the actual and potential impacts of the principal CROs on the entity's business model and strategy;
f. An analysis of the resilience of the entity's business model and strategy, taking into account consideration of different climate-related scenarios;
g. A description of the targets used by the entity to manage climate-related risks and to realise climate-related opportunities and of performance against those targets; and
h. Key performance indicators (KPIs) used to assess progress against targets used to manage climate-related risks and realise climate-related opportunities, and a description of the calculations on which those KPIs are based.

The disclosures must be made to a level of detail which enables a reader to understand the effect of CROs on the business without needing to refer to other sources of information, and should enable the reader to understand how the disclosures relate to the other information presented in the annual report. Information which would influence the decisions of investors should not be omitted.

Company directors have discretion to omit some or all of the requirements listed at (e) to (h) above where they are considered unnecessary for an understanding of the company's business, but must provide a clear and reasoned explanation as to why they believe it is appropriate to omit the information.

Overlap with Existing Disclosure Requirements

Under the FCA's Listing Rules, the framework of mandatory Taskforce on Climate-related Financial Disclosures (TCFD) aligned disclosures applies to standard-listed companies as well as certain asset managers and owners. The disclosure requirements imposed by the Regulations do not directly mirror or reference TCFD recommendations, but instead, are "*based on*" the TCFD recommendations, and have been adapted for inclusion in UK legislation.

Some listed companies will find themselves within the scope of two distinct sets of obligations—under the Regulations and under the Listing Rules. Government guidance has clarified that disclosures made in compliance with the Listing Rules will "*likely … meet the requirements of these regulations.*"

Non-Compliance and Enforcement

Where an in-scope entity is in breach of the Regulations, the Financial Reporting Council is empowered to make an application to court for a declaration of non-compliance. The court may then order the preparation of revised accounts (including the strategic report), as well as other sanctions at the court's discretion. Non-compliance by companies within the scope of both the Regulations and the Listing Rules may also attract FCA enforcement actions.

Conclusion

Now that certain companies and LLPs are part of the ever-growing group of entities required to make climate-related financial disclosures, their decision-makers should consider how best to implement these disclosure obligations in their governance practices. Government guidance, published to accompany the Regulations, provides detailed guidance as to the types of information which disclosing entities should include in each element of the reporting requirements. While the Regulations are not direct parallels of the TCFD's recommendations, the TCFD's publications also offers guidance and examples of best practice.

In line with the UK government's Roadmap on Sustainable Investing, smaller companies have been spared mandatory disclosures (for now), with the government stating a preference for "*the development of best practice, to support [them] to disclose should they wish to*." And for now, smaller companies are advised to observe in-scope entities to take note of what climate-related compliance may look like.

What to Watch

At the time of writing:

- The FCA is expected to publish its consultation paper on sustainable investment labelling in Q2 2022 and its feedback statement on environmental, social, and governance (ESG) integration in UK capital markets focusing on the sustainable debt market and the role of ESG data and rating providers before the end of H2 2022.
- On 12 May 2022, the UK government launched a call for evidence to update its Green Finance Strategy, first published in July 2019. The strategy sets out the role of the financial sector in delivering global and domestic climate and environmental objectives. The deadline for responses is 22 June 2022.