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LISTED COMPANIES: WHAT TO EXPECT IN 2022

After another tumultuous year in 2021, we look at developments expected this year that will affect the rules and expectations around listed companies. In this second briefing we focus on non-financial reporting, including disclosure of climate-related information aligned with the TCFD framework, diversity on boards and other climate change and ESG developments.

(Our first briefing – in which looked at what we expect to see in capital markets, particularly in relation to secondary fundraisings, possible changes to the listing segments and FCA rules for listed companies, and developments relating to financial reporting, including expected reforms to rules around audits - can be found here.)

Non-financial reporting

TCFD reporting under the Listing Rules: comply or explain

For financial years starting on or after 1 January 2021, **premium listed commercial companies** are required by LR 9.8.6R(8) to make climate-related disclosures in their annual reports based on the framework established by the Task Force on Climate-related Financial Disclosures (TCFD). Disclosures are not mandatory, but if a company does not include a disclosure then it must explain why. This year will see the first annual financial reports published under the new rule. For companies that already publish climate-related information on a voluntary basis – e.g. in a Sustainability Report – the new requirement may not entail much additional work; but for other companies it will add significantly to their reporting burden.

In December last year the FCA confirmed that the requirement to report against the TCFD framework would be extended to issuers of **standard listed shares and GDRs** (other than investment entities and shell companies). The new rule, LR 14.3.27R (which is aligned with the equivalent rule for premium segment companies), will apply for accounting periods beginning on or after 1 January 2022. In summary, such an issuer must include in its annual financial report a statement setting out:

- whether it has made disclosures consistent with the TCFD framework in its annual financial report;
- where it has not made disclosures consistent with some, or all, of the TCFD framework, an explanation of why, and a description of any steps the issuer is taking or plans to take to be able to make consistent disclosures in the future, and the timeframe within which it expects to be able to make those disclosures;
- where it has included some, or all, of the information mandated by the TCFD framework in a document other than its annual financial report, an explanation of why; and
- where in its annual financial report (or other relevant document) the various disclosures can be found.

For more details see our client briefing published in December 2020 about the new rule for premium segment companies and our client briefing published in June 2021 about the FCA's proposals to extend the rule to standard segment companies.

At the same time, the FCA updated LR 9.8.6R(8) to reflect guidance and other materials that have been published by TCFD over the last year, particularly the new TCFD *Guidance on Metrics, Targets and Transition Plans*, and the updated *Annex on Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures* (which

supersedes the 2017 version), both of which were published in October. In relation to transition plans, where a listed company is headquartered in, or operates in, a country that has made a commitment to a net zero economy (which includes the UK), it is encouraged to assess the extent to which it has considered that commitment in developing and disclosing its transition plan. Where the company has not done so, it is encouraged to explain why.

Large amounts of guidance and commentary on TCFD reporting have already been published, and more is likely to follow. Listed companies may find it particularly helpful to refer to:

- The FRC Lab report published on 28 October 2021: this includes practical advice and examples of good practice among companies that already make TCFD disclosures on a voluntary basis. The FRC Lab has also published a snapshot of the status of current reporting against the TCFD framework in the UK. As predicted, doing scenario analysis is acknowledged to be one of the biggest challenges for companies making TCFD disclosures: to help, the FRC has published research by the Alliance Manchester Business School that looks at climate-related scenario analysis in more detail, including the various approaches companies have adopted, examples of good practice, typical challenges faced and steps commonly taken to conduct the analysis.

- The London Stock Exchange guide to climate reporting published on 20 October 2021. The guidance is based on the United Nations Sustainable Stock Exchanges' Model Guidance on Climate Disclosure, which is aligned with the TCFD framework. It is intended to help companies integrate climate risks and opportunities into operational decision making and to report carbon performance.

Mandatory TCFD reporting for large companies etc

On 19 January 2022 the Government published the final details of changes to be made to the Companies Act 2006 to require certain large companies to disclose in their strategic report climate-related financial information that is aligned with the TCFD framework. Most listed companies will be in scope. The new disclosure requirements will apply to accounting periods starting on or after 6 April 2022. BEIS is expected shortly to publish Q&A guidance to help in-scope companies comply with the new rules.

Although the wording of the new statutory requirements to disclose climate-related financial information differs slightly from the wording of the TCFD framework, a premium or standard segment company that has been preparing to make all the disclosures specified in the TCFD framework should not need to do anything extra to comply with the new statutory requirements. However, listed companies that were planning to "explain" why they are not making certain disclosures mandated by the TCFD framework – for example, in relation to scenario analysis – will, as a general rule, need to make those disclosures for accounting periods starting on or after 6 April 2022. As an exception to this, information relating to the impact of climate-related risks and opportunities on the business model and strategy, scenario analysis and targets used by the company to manage climate-related risks and realise climate-related opportunities, and to measure performance against them, need not be disclosed if the directors reasonably believe such information is not necessary to understand the company's business.

Asset managers and asset owners

Also in December last year the FCA confirmed that FCA-regulated asset managers and asset owners - including life insurers and pension providers - will have to disclose how they take climate-related risks and opportunities into account in managing investments. They will also have to make disclosures about the climate-related attributes of their products. Although the rules came into effect on 1 January this year, they apply initially only to the largest firms; smaller firms must comply from 1 January next year. For more details see our client briefing published in June last year about the FCA's proposals.

Diversity on boards

In July last year the FCA consulted on proposals to amend the Listing Rules to require premium listed and most standard listed companies to disclose in their annual reports:

- whether certain proposed targets (see below) for gender and ethnic minority representation on their boards have been met as at a specific reference date selected by the company. Companies would be required to disclose any targets not met and explain why they have failed to do so; and

- standardised numerical disclosure in table form on the ethnic group and gender of members of the company's board and the most senior level of its executive management team.

The targets proposed by the FCA are:

- at least 40% of the board are women (including individuals self-identifying as women)
- at least one of the senior board positions (Chair, CEO, SFO or Senior Independent Director) is held by a woman; and
- at least one member of the board is from a non-white ethnic minority background.

The FCA also proposed new guidance suggesting that companies may also wish to include in their annual report:

- a summary of any key policies, procedures and processes which contribute to the improvement of board and executive management diversity;
- any mitigating factors which make achieving board diversity more challenging for the company; and
- any risks the company has identified in meeting targets in the next accounting period or any plans to improve diversity.

The final rules are expected to be published in Q1 of this year. Originally the FCA proposed that the new requirements should apply to accounting periods beginning on or after 1 January 2022, so that reporting would start to be seen in annual reports published for that year in spring 2023, but it is possible that the timing for implementation may slip. Nevertheless, the FCA is likely to encourage companies to make disclosures on a voluntary basis in annual financial reports published before then.

Later in the year, the FCA may consult on additional proposals to require companies to publish data on representation by sexual orientation or other diversity characteristics at board and senior executive management levels and/or whether diversity data reporting should be extended to a level below senior executive management. Any proposals to disclose representation by sexual orientation or other diversity characteristics are likely to raise difficult issues and be controversial.

Other climate change and ESG developments

Transition plans

In October last year the Government published a Policy Paper, *Greening Finance: A Roadmap to Sustainable Investing*, in which it confirmed it would introduce mandatory requirements for listed companies to publish climate transition plans. In November, HM Treasury published a Fact Sheet giving more detail on what a transition plan is and what will be required. Broadly, a transition plan should include:

- High-level targets the company is using to mitigate climate risk, including greenhouse gas reduction targets (for example, a net zero commitment);
- Interim milestones; and
- Actionable steps the company plans to take to hit those targets.

Initially (which is expected to mean from 2023) companies will have to publish transition plans that align with the Government's net zero commitment or explain why they have not done so. As generally accepted standards for transition plans are developed, the Government and FCA will look to incorporate such standards into UK rules and make transition plans mandatory as part of the UK's proposed Sustainability Disclosure Requirements (SDR) regime. A Transition Plan Taskforce has been tasked by the Government with developing a gold standard for transition plans and associated metrics: its report is due by the end of this year. (For more details of the proposed SDR regime and other Government proposals to green the financial system and encourage sustainable investing see our client briefing published in November.)

Some companies have already published climate transition plans voluntarily or have faced demands from investors to do so: for some examples see our client briefing published last April. Regulation in this area is therefore catching up with initiatives begun by climate action groups and adopted by some investors. Companies should start thinking now about what their transition plans would look like and be conscious that, even if initially they will be able to adopt a "comply or explain" approach, market practice, as well as wider shareholder and stakeholder pressures and expectations, may drive them to go further, sooner.

On a related note, we also expect shareholder activism on climate change issues to continue: for more details see our client briefing published in October last year.

Greenwashing

Legal claims brought by investors, regulators and other parties against companies and their directors in respect of misleading statements on ESG issues (sometimes referred to as "greenwashing") are already on the rise and are widely predicted to increase further. Companies need to temper their desire to present strong ESG credentials to investors and other stakeholders with the need to ensure that public statements are accurate and do not provide a hostage to fortune.

In general terms, companies can mitigate the risks of liability by taking the type of precautions that are usually taken where a company publishes a profit forecast in a prospectus or a takeover offer document. For example: ensuring that the information disclosed is clear, unambiguous and prepared carefully and supported by appropriate evidence; ensuring that the assumptions made are reasonable; that any targets or aspirations are realistic; and that, where necessary and feasible, verification or assurance is obtained from a suitable third party. Companies should also consider adding to the standard disclaimer in their annual report about forward-looking information an explanation of the purpose and limitations of disclosures relating to possible future scenarios and the company's resilience to them.

For more details see our client briefing published in November last year about greenwashing claims and our client briefing published in December 2020 about premium segment companies reporting against the TCFD framework.

Other ESG developments

In 2021 ESG developments occurred at a furious pace and this year is likely to be similar. Key developments from COP26 included countries submitting updated Nationally Determined Contributions (NDCs) towards reducing greenhouse gas emissions, the launch of the IFRS' International Sustainability Standards Board which will help standardise climate-related reporting, and agreement to phase down coal and phase out inefficient fossil fuel subsidies. The UK government also made side commitments that will impact on supply chains, production methods and procurement strategies. These include the Global Methane Pledge to reduce methane emissions by at least 30% from by 2030; the Global Coal to Clean Power Transition Statement committing to ending investment in new coal power generation and scaling up clean power generation; and the Declaration on Forests and Land Use to halt and reverse deforestation and land degradation by 2030.

Particular areas of focus for legislators, regulators and investors which could affect a wide range of companies are supply chains, deforestation and biodiversity. For example, EU legislators have proposed a new Directive on supply chain due diligence that would require most companies registered in a Member State or selling goods or providing services in the EU internal market to carry out effective due diligence on their supply chains to identify and address adverse impacts on human rights, the environment and the good governance of countries where they or their suppliers operate (for details see our client briefing published in April 2021). And both the EU and UK have recently proposed new rules designed to prevent the sale of products linked to deforestation or forest degradation.

Such developments are likely to apply to all companies, or all companies above a certain size, and not just those that are listed. As further developments occur we will publish further briefings. All our briefings on ESG, sustainability and climate change can be found here.

CONTACTS

REBECCA COUSIN
T: +44(0) 20 7909 3049
E: rebecca.cousin@slaughterandmay.com

RICHARD SMITH
T: +44(0) 20 7909 3386
E: richard.smith@slaughterandmay.com

JOHN PAPANICHOLA
T: +44(0) 20 7909 3031
E: john.papanichola@slaughterandmay.com

PETER BATEMAN
T: +44(0) 20 7909 4577
E: peter.bateman@slaughterandmay.com