How ready is the legal and governance framework in the United Kingdom to meet the challenge of climate change?

UKELA
Better law for the environment

Sectoral summary: corporate law

Q1: Is climate change expressly recognised in the legal framework for corporate law?

The principal legislation governing companies incorporated in the UK is the Companies Act 2006 (CA 2006). Although the CA 2006 does not expressly deal with climate change, there are a number of provisions that indirectly address the issue including:

- CA 2006, s 172 which requires a company's directors to consider the impact of the company's operations on the environment when fulfilling the duty to act in the way they consider would be most likely to promote the success of the company. Companies that have to prepare a strategic report must also include a section 172 statement describing how the directors have had regard to these factors when performing this duty to promote the success of the company
- CA 2006, s 415 which requires all companies (other than small companies) to prepare a strategic report. This must describe the principal risks and uncertainties the company faces and include key performance indicators, including information relating to environmental matters. Quoted companies must also include in the strategic report information about environmental matters, including the impact of the company's business on the environment

In addition to the strategic report, companies are also subject to a range of environmental legislation requiring narrative reporting, including mandatory greenhouse gas reporting in the directors' report. The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018 (SECR Regulations), SI 2018/1155 implement the government's policy on Streamlined Energy and Carbon Reporting (SECR) and bring in additional disclosure requirements for quoted companies and also introduce requirements for large unquoted companies and limited liability partnerships to disclose their annual energy use and greenhouse gas emissions, and related information.

Domestic organisations may further be required to report to the relevant regulator on environmental matters in accordance with regulatory regimes, such as:

- the environmental permitting regime
- the EU or UK emissions trading systems
- climate change agreements (CCAs)
- energy savings opportunity scheme (ESOS)

Commercial companies with a premium listing with accounting periods beginning on or after 1 January 2021 are required under the Listing Rules either to make climate-related disclosures consistent with the approach set out by the Task Force on Climate-related Financial Disclosures (TCFD), or explain why not. The Financial Conduct Authority (FCA) is currently consulting on extending these requirements to standard listed issuers.

Premium listed companies are also expected under the UK Corporate Governance Code (UKCG Code) to include a viability statement in the annual report, which amongst other things must consider the principal risks affecting the company. For many companies, climate change-related factors will be highly relevant considerations when making this statement.

In addition to the above legislation, Listing Rules and UKCG Code requirements, there are a plethora of different reporting frameworks, standards and benchmarks, which are intended to assist companies with reporting on climate change issues as well as best practice guidelines from a wide range of institutional investor representative bodies.

Q2: What are the main issues arising from climate change for the sector?

Climate change will impact individual companies in different ways depending on the size of company and industry sector.

On a general level, the increased risk of extreme weather events such as heatwaves, flooding, droughts and storms may impact companies' physical assets, operations and prospective profits. Companies will also need to adapt how they conduct their businesses in response to increased legislation and regulation in this area. Companies can expect increased focus from consumers and investors as climate change concerns move further up the agenda.

Climate change may also present opportunities for certain companies, in particular those that can develop new technologies, products and services which help combat climate change. The drive to improve resource productivity (eg, by increasing energy efficiency), has the potential to increase companies' profitability by reducing costs. Companies may also strengthen the resilience of their supply chains (eg, by reducing reliance on price-volatile fossil fuels and moving towards greener energy sources).

Q3: What initiatives are taking place within the sector to further the goal of achieving net zero and how might other sectors learn from that?

In addition to requiring listed issuers to report in line with the TCFD framework (see above), the FCA is currently consulting on proposals to introduce TCFD-aligned disclosure obligations for asset managers, life insurers and FCA-regulated pension providers, with a focus on the information needs of clients and consumers. Firms would be required to report annually on how they take climate-related risks and opportunities into account in managing or administering investments and to produce, annually, a baseline set of consistent, comparable disclosures in respect of their products and portfolios, including a core set of metrics.

Q4: What initiatives are taking place within the sector to adapt to climate change and how might other sectors learn from that?

In addition to the proposal to require certain financial services firms to make TCFD-aligned disclosure obligations, various initiatives are taking place at a sectoral level to reflect the challenges faced by businesses in those sector.

Q5: Is the regime effective in light of future challenges?

As the Listing Rule requirements to report in line with the TCFD framework only applies to premium listed commercial companies with accounting periods beginning on or after 1 January 2021, the first reporting against the new rules will occur in 2022. It is therefore too early to assess how effective the regime is in meeting the future challenges.

The EU Disclosure Regulation and Taxonomy Regulation also provide a framework for how the UK could enhance its environmental, social and governance (ESG) disclosure regime:

- The Disclosure Regulation introduces requirements for a disclosure framework on the integration of ESG risks, to be used by financial intermediaries both in investment decision-making or advisory processes, to enable end-investors to receive coherent and comparable disclosures on financial product and services relating to sustainable investments and sustainability risks
- The Taxonomy Regulation establishes an EU-wide classification system or 'framework' intended to provide businesses and investors with a common language to identify to what degree economic activities can be considered environmentally sustainable. It aims to 'provide clarity and transparency on environmental sustainability to investors, financial institutions, companies and issuers thereby enabling informed decision-making in order to foster investments in environmentally sustainable activities'

Q6: What are the top additional interventions (of any kind) that would improve the legal and governance framework in the sector?

There are a plethora of different reporting frameworks, standards and benchmarks, which are intended to assist companies with reporting on environmental, social and governance (ESG) issues. However, the sheer number of frameworks can be confusing for companies, investors and other stakeholders. There have been a number of initiatives aimed at establishing a global universal framework for companies to report against ESG issues, but to date no dominant framework has emerged.

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