

## REGULATORY INTELLIGENCE

**FRC report: challenge for businesses on net zero**

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The need for companies to enhance the quality and breadth of their "net-zero" commitments disclosures has been the subject of a recent Financial Reporting Council (FRC) Lab [report on net-zero disclosures](#).

In a 2020 [survey](#) Schroders reported that while investors' engagement with corporates on environmental issues was growing, six in 10 respondents cited "greenwashing" as a major concern. As well as reliability of information, Schroders found investors were also looking for comparability and consistency in disclosures.

Consistency will, in part, be driven by specific regulatory requirements, while firms can achieve comparability and reliability by improving the clarity and transparency of their climate-related disclosures.

**Regulatory landscape**

UK-listed and large private companies are subject to a range of voluntary and mandatory reporting requirements with respect to climate-related disclosures. Various international regulations and standards are also soon to be implemented or are under development, including the EU [Corporate Sustainability Reporting Directive](#) (CSRD) and the disclosure standards being developed by the International Sustainability Standards Board (ISSB).

The trend both in the UK and internationally is toward mandating and enhancing the scope of disclosure requirements.

The UK Financial Conduct Authority (FCA) recently introduced rules to require commercial companies in the UK with a premium listing, as well as standard listed companies, to state in their annual financial reports whether they have made disclosures consistent with the recommendations of the [Task Force on Climate-Related Disclosures](#) (TCFD) — and if not, why not.

Both the [FCA](#) and the [FRC](#) undertook a review of TCFD reporting following the introduction of the FCA's rules. Their findings were published in July, and provided valuable guidance on regulators' expectations of disclosing companies, as well as identifying several areas of improvement.

The FRC noted the need for greater granularity or specificity on impacts and the need to present a balanced view on risks and opportunities. It also underlined the interlinkage between the implications of climate-related scenario analysis and the strategy of the company as detailed in its strategic reports.

The FCA noted the increasing number of companies making net-zero commitments, although it flagged that, on analysis, some of those commitments "were often not clear and in some cases, they risked being misleading as a result".

**FRC recommendations**

The FRC Lab's report has picked up on some of these quality concerns in producing its fundamental, or "foundational", and aspirational, or "advanced", recommendations for companies on net-zero disclosures. In pulling together its recommendations, the FRC carried out a holistic assessment, securing the views of international investors, private investors, issuers and other stakeholders.

When compiling their disclosures, companies should be mindful not only of the strict disclosure requirements but also of those who are reading their reports. The FRC's report highlights the three most important elements that investors said they wanted to understand from disclosures: commitments, impacts and performance. The report also provides detailed examples of missteps or weaknesses in disclosures the FRC has picked up on, together with guidance on how to tackle these issues.

**Commitments**

Investors have detected confusion among disclosers about the meaning of "net zero" and what a "net zero" pledge constitutes, as opposed to a commitment to be "carbon-neutral" or "Paris-aligned". Disclosers need to be clear in their reporting about the scope of the commitment regarding the type of emissions, the scopes of emission, the specific business lines and geographies that are in or out of scope.

Disclosers also need to be transparent about the measurement tools they are deploying when setting their commitments, the timelines they are setting to achieve those commitments and the interim stages to achieving the commitments. They also need to state if, and to what extent, offsets are being used to achieve the commitments.

**Impacts**

Disclosures need to include a clear articulation of the strategy that has been adopted to achieve the "net-zero" or other relevant reduction or climate-related commitment. They should ensure that the implications of this strategy on the business' structure and operations have been identified and explained.

As the TCFD noted in its guidance on [metrics, targets and transition plans](#), net-zero commitments "inherently, and in some cases explicitly, require a plan". Investors are also keen to understand the risks and opportunities associated with the strategy, the expected costs and related timelines and, finally, what key assumptions and externalities underpin the strategy.

### **Performance**

In outlining how they are performing against their commitments, disclosers should set out clearly the standards or frameworks they are using to assess their performance. The FRC Lab's report noted that investors preferred companies to use established frameworks to measure their GHG emissions. It said further that investors preferred companies to set net-zero targets aligned to the Science Based Target initiative (SBTi) framework.

Where companies did use SBTi frameworks, they should also be clear whether their performance had been formally certified by the SBTi, and indeed whether, and to what extent, other data relevant to performance and achievement of targets had been subject to assurance, the report said.

Disclosers will need to set targets in conjunction with the adoption of any standard or framework, and the "ask" from investors is for greater clarity on what the short-, medium- and long-term targets are. Finally, in relation to performance, investors are generally of the view that tying net-zero targets to director remuneration could be helpful, and these should be tied to specific emission reductions or by reference to other specific metrics.

Investors recognise that, given the timeframes under consideration and the developing landscape, net zero is a journey, and that companies may need to change or update timelines and even their approach to achieving their commitments. What they are seeking is transparency, clarity and timely disclosures about any anticipated changes.

As part of his COP26 Finance Day [speech](#) last year, Rishi Sunak (the then-Chancellor) announced the UK's plan to become the first ever "Net-Zero Aligned Financial Centre" and to move toward making it mandatory for firms to publish clear, deliverable transition plans. The government subsequently set up the [Transition Plan Taskforce](#) (TPT) to develop a "gold standard" for transition plans, accompanied by appropriate frameworks and guidance.

To implement this objective, the FCA recently introduced mandatory requirements on listed companies and large regulated asset owners and asset managers to disclose transition plans as part of their TCFD-aligned disclosures, initially on a comply-or-explain basis.

The first disclosures under these mandatory rules will be made in 2023. With mandatory transition plan reporting around the corner and expected to expand, disclosers must take heed of the guidance in relation to climate-related commitments and targets issued by the FRC Lab and other organisations.

There have already been several examples in the UK of shareholders voting down companies' "net-zero" and transition plans at annual general meetings due to an apparent lack of substance and credibility. Listed companies should also be mindful of their general [Listing Rules](#) obligations to ensure that their disclosures are fair and not misleading. The FCA and the Competition and Markets Authority continue to focus on "greenwashing" more generally, and new regulations on green or sustainable labelling have been, or are expected to be, brought into force.

In the light of these developments, it is critical that disclosers devote time and attention to establishing appropriate systems and controls to deliver clear, credible climate-related commitment disclosures. The market is on notice.

### **COP27**

Several organisations have launched new initiatives this month to coincide with COP27. The need to develop and finance credible net-zero strategies and plans is very much on the minds of international climate-focused agencies.

In the UK, as trailed above, the Transition Plan Taskforce published its consultation paper with recommendations for companies and financial institutions on the proposed new mandatory Transition Plan disclosure framework. These essential industry tools and guidance are certainly welcome, and are put into sharp focus by the [report](#) of the UN High-Level Expert Group on Net Zero Emissions Commitments published this week.

The FRC Lab's report highlights concerns about "bogus" pledges and aims to provide a guide on ensuring credible commitments by providing clarity in four key areas: environmental integrity, credibility, accountability and the role of governments along this pathway. The U.N. Secretary General's message was clear: "We must have zero tolerance for net-zero greenwashing."

[Complaints Procedure](#)

