Thinking Aloud
"Say on Climate": An opportunity to deliver impact in the UK
20th November 2020

This note for Members outlines a proposal to embed climate discussions in the stewardship dialogue with premium listed companies in the UK and to provide a system-wide investor signal to companies on the effectiveness of their climate strategy.

A unique opportunity to impact UK companies

With the FCA's proposals to implement the new TCFD-aligned disclosure rule for premium listed companies with financial accounting periods on or after 1st January 2021, and the UK's aspiration to show a leadership role ahead of COP26 in November 2021, climate reporting is moving centre stage for companies and investors.

The forthcoming BEIS consultation provides an opportunity for investors to make the case for a 'say on climate' on TCFD-aligned disclosure obligations in the Companies Act in order to signal the importance of credible climate disclosures and the important need to articulate strategic responses.

A call to action

To deliver tangible benefits from these proposals, and drive real-world impact, we believe a non-binding shareholder vote would provide a powerful investor signal on the effectiveness of any mandated climate disclosures and deliver a material impact on the substance and ambition of company disclosures and strategic intent.

Such an approach would enable the investment community to take a leadership position in helping ensure that UK companies play a leading role in delivering the UK's net zero commitments.

A 'say on climate' – through a non-binding vote to approve a 'Climate Report' - would allow investors in UK companies to use the existing stewardship practices of engagement and voting to embed climate discussions in strategic dialogue with all premium listed companies.

We welcome your thoughts and insights on this proposal and how we might collectively build a compelling case for change.

Context

In this note, we set out the context, recent developments and enabling factors for this change, and position it within the established frameworks. We have summarised what we believe are key regulatory events which are likely to provide a unique opportunity to accelerate climate disclosures in the UK and make the case for an investor "say on climate", namely:

- the FCA's upcoming disclosure requirements for premium listed companies;
- the BEIS consultation on TCFD-aligned disclosure obligations in the Companies Act; and
- the roadmaps and initiatives developed as part of the COP26 agenda.

In recent weeks we have seen a significant increase in the intensity of debate surrounding plans to transition the economy to achieve net zero carbon emissions, and the associated disclosure of climate impact by companies and investors. This is particularly acute in the UK as preparations begin for COP26 and the political agenda shifts to create a narrative around the UK's leadership position on climate.

Powerful techniques have been developed to promote and sponsor shareholder resolutions and we applaud the work that has been done on a global scale by Climate Action 100+, IIGCC and ShareAction, amongst others, as well as the actions that a number of asset owners and asset managers have already taken to advance the debate. Our own experience engaging with Barclays to encourage the bank to set out clear climate ambitions is also a powerful example of how stewardship and engagement can complement shareholder resolutions.

A unique opportunity in the UK to embed climate discussions in the stewardship dialogue

We believe there is now an opportunity in the UK which has arisen from the government's desire to take a leadership position, and the push to mandate TCFD reporting by listed companies. We believe that a signal of investor confidence in the effectiveness of a company's climate strategy through a non-binding vote could bring a focus to the extensive work that many companies are undertaking to articulate their climate ambitions, and disclose these in an acceptable and consistent form.

Importantly, such an approach could be applied to all premium listed companies and would provide investors with a mechanism to signal which companies are making good progress and those that are lagging. It would use the established and accepted mechanism of a non-binding vote, and the existing stewardship techniques of engagement, to put climate at the heart of the strategic debate for all premium listed companies. This contrasts to the case-by-case approach of shareholder resolutions which of course could continue to be utilised as an escalation tool in situations where progress is felt to be insufficient.

Making the case for an investor say on climate in the UK

1. Green Horizon Summit – Mark Carney

Many of you will have heard Mark Carney speak at the Green Horizon Summit on 9th November. In that speech he made the case that every country will undergo a social reset and that every company will undergo a strategic reset, thereby firmly putting climate change at the heart of not just the political agenda but also the strategic dialogue. He also raised the idea of a 'say on climate' for investors could improve oversight of pledges to slash greenhouse gas emissions - "Rather than have authorities be overly prescriptive on plans, it may be desirable to have investors have a say on transition. This would establish a critical link between responsibility, accountability and sustainability"

2. UK Regulatory Roadmap

Also on 9th November, HM Treasury published 'A Roadmap towards mandatory climate related disclosures' (here) in conjunction with the Bank of England, BEIS, the FCA, DWP and the Pensions Regulator. The paper:

- references initiatives by the FCA to finalise rules and publish a policy statement by end 2020 to include TCFD-aligned disclosure rules in the FCA Listing rules for premium listed companies to take effect from 1st January 2021 and potentially extending to a wider scope of listed issues in 2022;

- indicates that BEIS is planning to consult on TCFD-aligned disclosure obligations in the Companies Act in the first half of 2021.

BEIS has already held a number of TCFD Stakeholder Engagement roundtable discussions, in which the Investor Forum has participated, and we have held follow up discussions with the FCA and HMT/COP26 team.

3. Sir Chris Hohn's 'Say on Climate' initiative

Separately, Sir Chris Hohn and The Children's Investment Fund Foundation has launched a Say on Climate campaign which calls for companies to:

- Provide a specific action plan, including a validated 1.5C Science Based Target;
- Disclose on all elements of the TCFD recommendations;
- Make full annual public disclosure to CDP; and
- Tie executive pay to the achievement of targets.

The clarity of this proposition is very powerful, and in many situations shareholder resolutions may be required to derive change, especially in jurisdictions where the policy environment is less progressive.

However, we believe that in the UK there is a unique opportunity to drive change for premium listed companies and improve the quality of disclosure and climate strategy market-wide without the need for individual company filings.

Investor Forum proposal

Giving shareholders a "say on climate" through a vote to approve a company's Climate Report (which would include the TCFD-aligned disclosures) would enable the market to focus further on environmental issues at this critical time. It would:

- build on any move by the UK to mandate TCFD reporting ahead of COP26;
- allow the UK to show genuine leadership at a national level, without compromising future work by international standard-setters;
- encourage private sector collaboration between companies and their shareholders seeking disclosures, and underlying climate approaches, that deliver effectively for both; and
- allow investors to play a crucial role in holding companies to account for delivery of commitments made.

We think that BEIS could effectively replicate the approach that it developed to elevate the status of the remuneration report and require an annual non-binding vote to approve the report. In particular:

- Investors would be empowered to send a clear signal to companies on the need for transparency on climate related issues.
- Shareholders would have an opportunity to recognise both effective disclosure and underlying actions being disclosed, to signal where disclosure is not acceptable, thereby promoting improved disclosure.
- Disclosure and accountability to shareholders would enable a natural process of engagement and, where necessary, shareholder resolutions to drive a more effective response.

The vote would need careful design to ensure consideration of TCFD disclosures in the context of broader corporate disclosures on climate, including the financial statements, and not just as a stand-alone report.

A further argument can be made regarding the need to equip Boards with the necessary knowledge and skills to manage this transition. Parallels can be drawn with the work of the Davies and Parker reviews on Board diversity, and a similar approach might inform the urgency with which a Board makes the step change necessary to address these challenges. Encouraging the work of groups such as Chapter Zero could have a meaningful impact in delivering the effectiveness of any mandated change.

Benefits of such an approach

The combination of enhanced disclosure and an investor vote provide a mechanism to ensure that climate considerations are situated at the core of effective stewardship. In addition:

- Such an approach would build on existing UK practice, which BEIS has experience of, through the introduction of the remuneration report and the accompanying non-binding shareholder vote which gave investors a so-called "say on pay".
- At its best, the "say on pay" approach has delivered more thoughtful dialogue between companies and their shareholders on the issue of executive pay, leading to increased understanding of expectations on both sides. We would hope that introducing a "say on climate" could lead to the same dynamic in the crucial area of climate, building greater understanding and better approaches to the largest challenge which business – and the world - currently faces.
- If investors were to be tasked with holding companies to account on the effectiveness of climate disclosures, it would add strength to the reporting requirement and would likely drive significant

progress in the listed company sector's contribution to the UK's target of achieving Net Zero by 2050.

- Such an approach would also dovetail effectively with Stewardship Code's focus on engagement and exercising rights and responsibilities, as well as the work that BEIS is undertaking on shareholder resolutions.

In summary, we think that there is a powerful argument to combine mandated reporting requirements and stewardship responsibilities to deliver a material impact on company behaviour and make a contribution to developing a leading position for the UK in climate transition.

Next steps

We are interested in Member views. Please help us to understand:

- **any barriers to the effectiveness of this plan;**
- **key issues that you might have as an investor; and**
- **how we can collectively seize this opportunity for investors to materially advance the climate debate with premium listed UK companies**.

Investor Forum **20th November 2020**