

# **The Climate-related Financial Disclosure Regulations 2022: A step in the right direction for ESG in the private sector**

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## **Key words**

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## **Abstract**

This legislative note examines the recent regulatory changes that were introduced on 6 April 2022, and which consequently affect the Companies Act 2006 and the Limited Liability Partnerships (Account and Audit) (Application of Companies Act 2006) Regulations 2008. The amendments mean that companies and limited liability partnerships (LLPs) that fall within the regulations' scope must now disclose their climate change risks and opportunities. It is submitted in this work that these amendments are a step in the right direction for "environment social governance" (ESG) in the private sector. Indeed, the need to report on climate change risk is likely to drive the appetite of affected businesses to develop their ESG programs within their overall risk management frameworks. Together with this intrinsic impact, the changes are also likely to increase ESG and CSR within the markets more broadly.

## **Introduction**

This legislative note evaluates the recent changes that have been made to the Companies Act 2006,<sup>1</sup> and the Limited Liability Partnerships (Account and Audit) (Application of Companies Act 2006) Regulations 2008,<sup>2</sup> in respect to the climate change disclosure requirements of certain companies and limited liability partnerships (LLPs). The amending regulations are, viz:

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<sup>1</sup> Companies Act 2006.

<sup>2</sup> Limited Liability Partnerships (Account and Audit) (Application of Companies Act 2006) Regulations 2008 (2008/1911).

- (i) the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 (hereafter, the “Companies Regulations 2022”);<sup>3</sup> and moreover,
- (ii) the equivalent amendments which have been made to LLPs pursuant to the Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022 (hereafter, the “LLP Regulations 2022”).<sup>4</sup>

The regulations at issue were brought into force on 6 April 2022,<sup>5</sup> and the amendments that are created apply ‘in respect of financial years beginning on or after that date.’<sup>6</sup> Together with their individual designations, both above-named regulations may be conveniently and conjointly referred to as the “Climate-related Financial Disclosure Regulations 2022”, or, more simply, as “the regulations”, throughout this note.

This note is ultimately concerned with this secondary legislation that has been created to prompt greater private sector reporting on climate-related risks and opportunities<sup>7</sup> for: publicly quoted companies, large private companies, and LLPs.<sup>8</sup> It is hereby argued that their

<sup>3</sup> Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 (SI 2022/31).

<sup>4</sup> Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022 (SI 2022/46). For a succinct description of these changes, see, ‘Essential Corporate News – week ending January 21, 2022’ (*Norton Rose Fulbright*, January 2022) <<https://www.nortonrosefulbright.com/en/knowledge/publications/991be932/essential-corporate-news-week-ending-january-21-2022>> accessed 2 May 2022.

<sup>5</sup> Department for Business, Energy & Industrial Strategy, ‘Mandatory climate-related financial disclosures by publicly quoted companies, large private companies and LLPs: Non-binding guidance’ (HM Government, February 2022) 6 <[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/1056085/mandatory-climate-related-financial-disclosures-publicly-quoted-private-companies.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1056085/mandatory-climate-related-financial-disclosures-publicly-quoted-private-companies.pdf)> accessed 2 May 2022.

<sup>6</sup> ‘Mandatory climate-related financial disclosures for large companies’ (*Simmons & Simmons*, 23 February 2022) <<https://www.simmons-simmons.com/en/publications/ckz49qxok1ent0a27fu6c53wd/mandatory-climate-related-financial-disclosures-for-large-companies>> accessed 2 May 2022.

<sup>7</sup> Above n. 5.

<sup>8</sup> *Ibid.*

enactment is a step in the right direction for “environmental, social, and governance” (ESG) programs in the private sector, and for managing the threat of climate change therein. Inwardly, further reporting is going to be intrinsically good for ESG considerations and programs within the private sector; the principal benefit will certainly stem from the increased transparency and accountability that is likely to now be seen through the disclosure of climate-related data through reporting streams. Outwardly, of course, increased ESG considerations is highly likely to further assist in the greening of the markets and their actors; and ultimately, this should assist in the design and percolation of further non-financial policies more widely, leading to better “corporate social responsibility” (CSR) initiatives and programs. These terms are thoroughly defined, and discussed further, in the section of this note which provides the author’s analysis of the impact of the regulations.

This note is structured simply, and as follows: First, background information is provided on what the changes are and why they have been brought into force. Secondly, a detailed overview of the 2022 regulations is provided, demonstrating the new legislations’ scope and requirements. Thirdly, the author goes on to set out their ideas about how the regulations are likely to impact the private sector and the markets in respect to ESG and CSR commitments. Within this third section, ESG, as a concept, is defined and such programs are considered as part of companies and LLPs’ “risk management” techniques more generally. Finally, the note provides a conclusion to sum up the themes that lie within the work.

## **Background**

Given that it has been many years since the Companies Act 2006 was brought into force, it is inevitable that some of its sections, and the 2008 Regulations, require updating to better

reflect the modern commercial reality of dealing with “non-financial risks”. Whilst in the 21<sup>st</sup> century the term “non-financial” risks may not be the most helpful, with the differences that exist between “financial” and “non-financial” risks becoming increasingly blurred, the term is still used here to distinguish the two categories and to reflect the language used within the literature. It is acknowledged however that while climate change is a risk that is external from, what may be called, the “pure” financial risks (e.g., credit and securities risks),<sup>9</sup> ESG issues can nevertheless cause significant financial damage to the private sector.

The need for such updating of the Companies Act 2006 and the 2008 Regulations is illustrated for example, and *inter alia*, by the need to now comply with the government’s Net Zero Strategy and the findings of the Task Force on Climate-related Financial Disclosures (TCFD).<sup>10</sup> The TCFD findings are of particular note. It may be suggested indeed that the 2017 TCFD Report is the *fons et origo* of the Climate-related Financial Disclosure Regulations 2022. The TCFD’s 2017 report warned that, ‘One of the most significant, and perhaps misunderstood, risks that organizations face today relates to climate change.’<sup>11</sup> Amongst other things, the Task Force recommended that the ‘preparers of climate-related financial disclosures provide such disclosures in their mainstream (i.e., public) annual financial filings.’<sup>12</sup> And the regulations’ amendments that have been instigated can be seen as an example of putting this recommendation into practice. The importance of the TCFD’s report cannot be understated as it has similarly influenced the reporting of “climate change

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<sup>9</sup> L.A. Brown, ‘Bad debt and green issues: Managing environmental risks in borrowers’ corporate insolvencies’ (2018) 20(3) ELR 137.

<sup>10</sup> Department for Business, Energy & Industrial Strategy, ‘Net Zero Strategy: Build Back Greener’ (HM Government, October 2021).

<sup>11</sup> Task Force on Climate-related Financial Disclosures, ‘Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures’ (TCFD, June 2017) 3 <<https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf>> accessed 2 May 2022.

<sup>12</sup> Ibid. at (iv).

risk” in the law governing pension fund trusts, and particularly occupational pension schemes.<sup>13</sup> Given its importance in developing climate-related risk appreciation in the private sector, the Task Force warns that, ‘Climate change poses risks to companies, financial institutions and individuals alike. Both physical and transition risks could have material impacts on the value of companies and their assets’.<sup>14</sup> This is clearly echoed in the guidance document which supports, and explains, the regulations (hereafter, “the guidance”).<sup>15</sup> Undeniably the guidance is interesting for the fact that it clearly acknowledges the findings of the TCFD,<sup>16</sup> which can be viewed as instrumental for the creation and enforcement of the regulations.<sup>17</sup>

Undoubtedly the regulations in question are a part of the larger, and important, trend of climate-related reporting requirements that have emerged within the financial markets, and within the companies and institutions that operate within those markets. While this increased “greening” of the financial markets has made companies and partnerships susceptible to “greenwashing” their business activities,<sup>18</sup> it is nonetheless argued here that the regulatory amendments are going to be beneficial inwardly and outwardly for affected companies and LLPs and the markets more generally.

## **The Climate-related Financial Disclosure Regulations 2022**

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<sup>13</sup> Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021, SI 2021/839. See also, Pension Schemes Act 2021, s 124.

<sup>14</sup> Above n. 5 at 5.

<sup>15</sup> Above n. 7.

<sup>16</sup> Ibid. at 5.

<sup>17</sup> Ibid.

<sup>18</sup> Stephen Morris, ‘HSBC faces greenwashing accusations from UK advertising watchdog’ Friday, *Financial Times* (London, 29 April 2022) <<https://www.ft.com/content/6c08ae5f-214f-4a5f-801e-6c849a3e517d>> accessed 2 May 2022.

The regulations at issue have been clearly introduced in the above section but are further explained here. These regulations were created on 17 January 2022 and brought into force on 6 April 2022.<sup>19</sup> They apply to the financial years starting on or after the date of their enforcement.<sup>20</sup> There are no exemptions for any business that falls within their scope,<sup>21</sup> and the Secretary of State must review the provisions ‘from time to time’<sup>22</sup> and ‘publish a report setting out the conclusions of the review’;<sup>23</sup> this first report is to be published before 6 April 2027.<sup>24</sup>

In a document setting out the “roadmap to sustainable investing”, which was also heavily influenced by the Task Force’s 2017 report (as above),<sup>25</sup> the Chancellor of the Exchequer, Rishi Sunak MP, stated that the government is committed to:

‘Ensuring the financial sector is equipped to play its part is vital. Aligning the financial system with a sustainable future will bring real benefits for the environment and society. It is an opportunity to boost economic growth, create jobs, and level up the UK regions.’<sup>26</sup>

Thus these regulations have been directly influenced by the government’s desire to “green” the financial sector, following its year as the holder of the COP26 Presidency. Moreover,

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<sup>19</sup> Above n. 5 at 4.

<sup>20</sup> Companies Regulations 2022, reg. 1(1)-(2).

<sup>21</sup> Above n. 5 at 9.

<sup>22</sup> Companies Regulations 2022, reg 5(1)(a).

<sup>23</sup> Ibid. at reg 5(1)(b).

<sup>24</sup> Ibid. at reg 5(2).

<sup>25</sup> HM Treasury, ‘Greening Finance: A Roadmap to Sustainable Investing’ (HM Government, October 2021) <<https://www.gov.uk/government/publications/greening-finance-a-roadmap-to-sustainable-investing>> accessed 2 May 2022.

<sup>26</sup> Ibid. at 2.

under the Paris Agreement, the UK government is ‘bound by international law to act consistently with the new global-level aims of limiting global warming well below 2 °C; pursuing efforts to 1.5 °C and achieving net zero emissions in the second half of the century.’<sup>27</sup>

### *Scope*

It is necessary to begin by outlining the scope of the Climate-related Financial Disclosure Regulations 2022. Disclosures are to be made in the strategic report at the group level, or at the company level where there is no consolidated reporting.<sup>28</sup> Therefore subsidiaries within a consolidate group of a UK parent are not required to separately report their climate-related risks and opportunities, as these will be made known in the consolidated report.<sup>29</sup> However, the “global operations” of companies and LLPs are required to be disclosed in the report, so the scope is not only specific to UK operations.<sup>30</sup>

It is clear from the guidance that the disclosure requirements apply to large companies and LLPs.<sup>31</sup> However, that is not too discouraging as supply chains and market forces should assist in driving change in small to medium size businesses, too. To briefly expand on this point, as large companies must now comply with the legislation that requires climate reporting on, *inter alia*, risks and opportunities and processes, it may be likely that they will demand additional compliance from companies that fall within their supply chain but are not subject to the new regulatory demands. In accordance with the guidance the categories of

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<sup>27</sup> ‘Explanatory Memorandum on the Paris Agreement’ ([gov.uk](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/558185/EM_Paris_Ag.pdf), no date) <[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/558185/EM\\_Paris\\_Ag.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/558185/EM_Paris_Ag.pdf)> accessed 2 May 2022.

<sup>28</sup> Above n. 5 at 7.

<sup>29</sup> Ibid.

<sup>30</sup> Ibid.

<sup>31</sup> Ibid.

companies and LLPs that are subject to the climate disclosures under the regulations include the following:

- All companies that are currently required to produce a non-financial information statement, being UK companies that have more than 500 employees and have either transferable securities admitted to trading on a UK regulated market or are banking companies or insurance companies (Relevant Public Interest Entities (PIEs));
- UK registered companies with securities admitted to AIM with more than 500 employees;
- UK registered companies not included in the categories above, which have more than 500 employees and a turnover of more than £500m;
- Large LLPs, which are not traded or banking LLPs, and have more than 500 employees and a turnover of more than £500m and;
- Traded or banking LLPs which have more than 500 employees.<sup>32</sup>

Further information about the guidance's above summary of affected companies and LLPs can be found in regulations 3 and 2 of the Companies' Regulations 2022 and the LLP Regulations 2022, respectively. Now that the remit of the legislation has been made known, the section below sets out, in greater detail, the reporting requirements that have been brought into force under the legislation.

### ***Disclosure requirements***

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<sup>32</sup> Ibid.

The new regulations affect existing legislation, as has been already noted. More specifically however, amendments are made to sections 414C, 414CA and 414CB of the Companies Act 2006,<sup>33</sup> and sections Regulations 12A and 12B of the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008.<sup>34</sup> The guidance states that, ‘These regulations for companies and LLPs both require climate-related financial disclosures to be made against a common list of requirements.’<sup>35</sup> Under regulation 4 of the Companies Regulations 2022, ‘The non-financial and sustainability information statement must contain the climate-related financial disclosures of the company’.<sup>36</sup> This is echoed in regulation 4 of the LLPs Regulations 2022.<sup>37</sup> Indeed, the guidance fleshes out the reporting requirements in further detail. It states that, to comply with the new disclosure obligations, companies and LLPs must provide the following in their strategic reports:

- (a) a description of the governance arrangements of the company or LLP in relation to assessing and managing climate-related risks and opportunities;
- (b) a description of how the company or LLP identifies, assesses, and manages climate-related risks and opportunities;
- (c) a description of how processes for identifying, assessing, and managing climate-related risks are integrated into the overall risk management process in the company or LLP;
- (d) a description of—
  - (i) the principal climate-related risks and opportunities arising in connection with the operations of the company or LLP, and

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<sup>33</sup> Ibid. at 6.

<sup>34</sup> Ibid.

<sup>35</sup> Ibid. at 9.

<sup>36</sup> Companies Regulations 2022, reg. 4.

<sup>37</sup> LLPs Regulations 2022, reg. 4.

- (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 climate-related risks and opportunities on the business model and strategy of the company or LLP;
- (f) an analysis of the resilience of the business model and strategy of the company or LLP, taking into consideration of different climate-related scenarios;
- (g) a description of the targets used by the company or LLPs to manage climate-related risks and to realise climate-related opportunities and of performance against those targets; and
- (h) the key performance indicators 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 key performance indicators are based.<sup>38</sup>

It is important to note that some of the above information may indeed have been disclosed within some companies' annual review documentation before the inception of the legislative changes. However, a system that allows companies to drive the degree of the reporting inevitably results in inconsistent reporting and differing data.<sup>39</sup> This can be seen by a viewpoint that was expressed by the Financial Reporting Council in 2019, namely:

While different companies will be affected by climate change in different ways, many will need to respond to potential increases in cost and/or decreases in revenue... For some companies, climate-related issues are material now, with impacts already

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<sup>38</sup> Above n. 5 at 9-10.

<sup>39</sup> Financial Reporting Council, 'Climate-related corporate reporting – Where to next?' (FRC, October 2019) <<https://www.frc.org.uk/getattachment/22ee8a43-e8ca-47be-944b-c394ecb3c5dd/Climate-Change-v9.pdf>> accessed 24 May 2022

disrupting supply chains and changing consumer behaviour. For others, climate-related issues are key to longer-term strategic planning decisions.<sup>40</sup>

The above information needs to be reported in the “Non-Financial and Sustainability Information Statement”, and in a manner so that the reader is able to clearly understand the climate-related risks and opportunities that are associated with a given company or LLP.<sup>41</sup> Additionally, the information must also be ‘included within the Annual Report and Accounts.’<sup>42</sup> It need not take on any particular format or structure,<sup>43</sup> but the level of detail that is required should be such that a reader would not have to undertake further research to understand the risks and opportunities associated with the company or partnership.<sup>44</sup> Thus the information that is necessitated is that which allows and contributes to a person’s ‘understanding of the business.’<sup>45</sup> In this respect company directors, who are the ones that now have a legal duty to provide the information in their company’s or LLPs’ Annual Report,<sup>46</sup> are able to omit any such information that they deem is unnecessary for a person to understand the business.<sup>47</sup>

Perhaps the ability to omit information that is not necessary for a person to understand the business may emerge as a potential area of contention in the future, but only time will tell. While one can only speculate about this at the time of writing, the author believes that the directors’ ability to omit information from the information statement and annual report

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<sup>40</sup> Above n. 5 at 3.

<sup>41</sup> Ibid. at 17.

<sup>42</sup> Ibid.

<sup>43</sup> Ibid. at 18.

<sup>44</sup> Ibid. at 17.

<sup>45</sup> Ibid.

<sup>46</sup> Ibid. at 18.

<sup>47</sup> Ibid. at 17.

should not be too damaging for climate risk reporting. As suggested above, the legislative changes state that company reporting should exhibit a level of detail to assist external parties from understanding the business, and climate risk and opportunities will inevitably form a part of that information. In short, it is unlikely that a company director would be able to “cover up” their climate risk and opportunities since these are materially significant to understanding the business and will ultimately have to be reported as such.

Now that the regulations and their guidance have been outlined, the below section discusses the impact of the climate-related disclosures on the companies and LLPs that are captured within the regulatory framework’s scope. It is also necessary to outline how the amendments may benefit the economic markets more generally.

### **The impact of the regulations**

Before anything else, it is worthwhile briefly explaining the main differences between ESG and CSR. It should be noted that this commentary is primarily concerned with the former concept, albeit the latter is still something that needs to be considered in outline. As Cook explains, ‘the major difference between them [ESG and CSR] is that CSR is a business model used by individual companies, but ESG is a criterion that investors use to assess a company and determine if they are worth investing in.’<sup>48</sup> Gorley confirms Cook’s definition, as follows:

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<sup>48</sup> James Cook, ‘What is the difference between ESG and CSR?’ (*Business Leader*, 2 September 2021) <<https://www.businessleader.co.uk/what-is-the-difference-between-esg-and-csr/#:~:text=Whilst%20ESG%20and%20CSR%20are,they%20are%20worth%20investing%20in>> accessed 2 May 2022. Brackets added.

CSR initiatives are voluntary and tend to focus on improving a company's relationships with external constituencies. For example, CSR managers might oversee corporate philanthropy or partnerships with community groups. ESG programs are generally implemented as a broader corporate strategy to address investor or regulatory demands. ESG practice involves fairly rigorous measuring and reporting on environmental, social, and corporate governance activities to understand the risks and impacts.<sup>49</sup>

Subsequent to making the above observation, Gorley thereafter goes on to describe the difference between ESG on the one hand and “risk management” techniques on the other. And this is pertinent for this analysis also. He explains that: ‘An ESG program is a form of risk management. A wide range of stakeholders – from investors, lenders, and government agencies, to communities, customers, employees, and others – is looking at ESG performance.’<sup>50</sup> By creating mandatory reporting the regulations will directly impact upon the ESG programs of affected entities. This opinion strongly corresponds with Gorley’s thoughts, i.e., ‘An ESG rating and the information used to calculate the score provide investors and executives with tools to evaluate a company’s ESG performance and risk management.’<sup>51</sup>

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<sup>49</sup> A. Gorley, ‘What is ESG and Why It’s Important for Risk Management’ (*Sustainalytics*, 2 March 2022) <<https://www.sustainalytics.com/esg-research/resource/corporate-esg-blog/what-is-esg-why-important-risk-management#:~:text=ESG%20Explained&text=An%20ESG%20program%20is%20a,looking%20at%20corporate%20ESG%20performance>> accessed 2 May 2022.

<sup>50</sup> Ibid.

<sup>51</sup> Ibid.

The use of risk management is not new. Environmental risks arguably first came onto the agenda of the private sector in the late 1990s and early 2000s.<sup>52</sup> The early environmental regulatory frameworks that were enforced primarily created regulatory risks for businesses.<sup>53</sup> These new risks greatly encouraged the development of specific “environmental due diligence” methods as a means to mitigate the new threats;<sup>54</sup> this can be seen particularly clearly in commercial bank lending, where environmental due diligence techniques were specifically developed to process loan applications.<sup>55</sup> Hart acknowledges the importance of risk management as a tool for adapting to climate-related risks, viz:

Risk management approaches to climate change have evolved during the past decade [his book was published in 2016, it should be noted], with the development of new products and structured financial arrangements to manage an expanding array of risks. These mechanisms are gaining attention in the international climate negotiations and could become an important element of adaptation efforts implemented under the UNFCCC.<sup>56</sup>

Therefore, it is hoped that the regulations will affect companies and LLPs inwardly and outwardly. Inwardly, because improved ESG reporting will inevitably reduce the instances of the “physical” and “transition” climate change risks that may be incurred.<sup>57</sup> Hart states, for example, that, ‘A warming climate increases the magnitude, impact and complexity of various types of risks … As risks become more inter-related, their complexity can undermine

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<sup>52</sup> L. Brown, ‘Land pollution, environmental risks and bank lending’ (2015) 17(4) ELR 237.

<sup>53</sup> Ibid.

<sup>54</sup> Ibid.

<sup>55</sup> Ibid.

<sup>56</sup> C. Hart, *Climate Change and the Private Sector* (Routledge: London, 2013) at 210. Brackets added.

<sup>57</sup> Above n. 5 at 5.

our ability to accurately assess risks and our potential exposure of them.<sup>58</sup> And it is clear that physical and transitional risks have been a significant driver for the creation of the 2022 regulations, given that they are defined in the guidance:

Physical risks are those arising from the climatic impact of higher average temperatures (such as the increased frequency and severity of extreme weather events), whilst transition risks are those arising from the changes in technology, markets, policy, regulation, and consumer sentiment which will result from our transition to net zero.<sup>59</sup>

As well as inwardly affecting businesses, this legislative note also believes that the changes will be outwardly beneficial to the markets. It is submitted that the development of a widespread ESG criterion for climate-related risks and opportunities should provide a better means of assessing ESG performance. Such a criterion creates a reputational risk for affected businesses, as a lower ESG performance rating may act to impede investor confidence, amongst other things. Moreover, the need to publicly expose climate change data may lead to ignominious vitriol for some, and the threat of this could drive affected businesses to find more innovative solutions for dealing with climate change.<sup>60</sup> That said, as well as increasing the appetite for ESG within the private sector, it is hoped that the regulations will strengthen CSR within the markets more generally. Even though the need to disclose climate change risk and opportunities under the respective regulations applies to large businesses, it is also likely that small and medium sized businesses will adopt greener initiatives in response to supply chains' demands, etc.

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<sup>58</sup> Above n. 56 at 210-211.

<sup>59</sup> Above n. 5 at 5.

<sup>60</sup> Above n. 49.

Encouragingly, there is empirical evidence to demonstrate that reporting is an important method for making financial institutions and businesses more environmentally astute. For instance, very similar reporting requirements have been created for pension fund trusts.<sup>61</sup> In fact, the guidance comments on the link that lies between the present regulations and the Occupational Pension Scheme (Climate Change Governance and Reporting) Regulations 2021, which is the statute enforcing climate-related reporting amongst pension funds.<sup>62</sup> It states that, ‘Those large pension schemes are likely to have significant investments in companies that are within scope of these regulations. Disclosures provided by companies will inform the disclosures of large pension schemes under the pensions legislation.’<sup>63</sup> And vice versa. Interestingly, given the case law in this area,<sup>64</sup> the pensions legislation now mandates that climate change risk be considered as a “financially material risk” that needs to be reported within the pensions’ Statement of Investment Principles (SIP).<sup>65</sup> The SIP is not too dissimilar to companies’ information statements and annual reports. While it is outside the scope of this commentary to provide a comparison of these two systems of reporting, it is necessary to opine that both operate to disseminate important information to interested parties, and this should assist in protecting the environment through sectoral “greening” and improved ESG and CSR practices.

Another interesting observation that may be made is how climate risks and opportunities may be treated by pensions, LLPs, and companies. For instance, are these specific risks and

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<sup>61</sup> L. Brown, ‘Towards “Green” Trusteeship: new statutory amendments for occupational pension trustees’ (2019) 25(10) *Trusts & Trustees* 978.

<sup>62</sup> Above n. 17.

<sup>63</sup> Above n. 5 at 20.

<sup>64</sup> See, *Cowan v Scargill* [1985] Ch 270.

<sup>65</sup> Pension Schemes Act 2021, s. 124.

opportunities, by their very nature, viewed as purely financial risks or purely non-financial risks or something of a hybrid? Again, this line of thought may fall outside of the scope of this work, but the author wishes to raise it nonetheless to encourage and promote the possibility of further research on this matter. While it may be too early to tell how companies and LLPs, as a collective, view climate-related risks and opportunities, it is clear that within the pension sector climate change has transcended to a type of financially material risk.<sup>66</sup> And the above observation may come as a surprise to some given the well-known judgment of Sir Robert Megarry VC in *Cowan v Scargill* [1985], where he stated that the “best interests” of beneficiaries are their “best financial interests”.<sup>67</sup> However, in evaluating Megarry’s judgment and interpretation of the word “benefit”, it would be entirely wrong to suggest that the Vice Chancellor was stipulating that investment opportunities should be sequestered into the purely financial and the purely non-financial opportunities.<sup>68</sup> Indeed Megarry’s judgment runs much deeper than that, and can be used to propitiate the advocates of better ESG governance and reporting.<sup>69</sup> The reason for this is because Megarry understood that the word “benefit”, when applied to trusts, is flexible, broad, and elusive.<sup>70</sup> As it is with pension funds so to it must be applied to companies and LLPs. It is greatly hoped that the regulation’s consolidated approach to reporting risks and opportunities will provide greater clarity in the sector, together with assisting in developing the knowledge and understanding of how companies and LLPs perceive risks and opportunities more generally.

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<sup>66</sup> L. Brown, ‘*Cowan v Scargill* and the fiduciary duty of investment: has the nature of the investment duty changed and what is currently driving “socially responsible investing” in pension schemes?’ (2020) 26(8-9) Trust & Trustees 756.

<sup>67</sup> *Cowan v Scargill* [1985] Ch 270 (Sir Robert Megarry) at 287.

<sup>68</sup> Above n. 66 at 761.

<sup>69</sup> Ibid.

<sup>70</sup> Ibid.

A further reason why pensions have been singled out is because of the sector's significant wealth, and ultimately, its ability to affect the markets through their investment policies and opportunities.<sup>71</sup> This explains why, in the present regulations, large companies and LLPs have been specifically targeted. Interestingly, in recent years, it is evident that pensions have divested heavily from fossil fuels, with some having already fully divested from this sector on behalf of their beneficiaries.<sup>72</sup> The link between this divestment phenomenon and the new climate duties imposed on pension fund trustees and managers remains unclear. However, it would not be incorrect to say that the need to report climate-related risks, as a financially material risk, is likely to have had some bearing on this investment trend.<sup>73</sup> It may therefore be argued that the change of investment appetite amongst pension trustees and managers suggests that regulation is impacting on the financial markets' understanding, and approaches to, climate change risks and opportunities. It is hoped that the Climate-related Financial Disclosure Regulations 2022 will be equally as impactful for companies and LLPs.

## **Conclusion**

In conclusion, this legislative note has set out the changes that have been brought into force by the Climate-related Financial Disclosure Regulations 2022. It argues that the changes that have been implemented to update the law in respect to companies and LLPs is a positive step in the right direction. The note has delineated the scope of the regulatory changes, as well as providing an account of the disclosure requirements that are now mandated for certain businesses. Together with describing the enforced changes, this note has also provided some

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<sup>71</sup> L. Brown, 'The Pension Schemes Act 2021: new duties for trustees and managers of pension fund trusts' (2021) 27(9) *Trusts & Trustees* 880, 884.

<sup>72</sup> P. Collinson, 'UK's biggest pension fund begins fossil fuels divestment' *The Guardian* (London, 29 July 2020) <<https://www.theguardian.com/environment/2020/jul/29/national-employment-savings-trust-uks-biggest-pension-fund-divests-from-fossil-fuels>> accessed 2 May 2022.

<sup>73</sup> Above n. 71.

analysis of their possible impact, looking both inwardly and outwardly. Inwardly, businesses will unavoidably be moved by the need to react to the regulations, and this should, in turn, lead to greater ESG considerations within the private sector. That said, the exact risk management processes that will be created in the light of the amending regulations falls outside the scope of this piece of work and may be left for further research. Additionally, there is likely to also be outward effects of the need to report climate change risks and opportunities more greatly. Reporting will inevitably create reputational risks for businesses, and a failure to meet the ESG criterion may lead to, *inter alia*, increased public scrutiny and a lack of investor confidence, with this legislative comment noting empirical evidence of the possible link between reporting and greater ESG consideration, through the amendments that have been made to occupational pension schemes.

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