EXPLANATORY MEMORANDUM TO

THE COMPANIES (STRATEGIC REPORT) (CLIMATE-RELATED FINANCIAL DISCLOSURE) REGULATIONS 2021

2021 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Business, Energy and Industrial Strategy and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument makes changes to reporting requirements by certain companies to produce additional disclosures in line with the recommendations of the Taskforce on Climate-related Financial Disclosures which were published in 2017. A separate instrument will make parallel changes to reporting requirements by certain limited liability partnerships (LLPs).

2.2 The Government recognises the recommendations of the Financial Stability Board's (FSB) Taskforce on Climate-related Financial Disclosures (TCFD) as one of the most effective frameworks for companies to analyse, understand and ultimately disclose climate-related financial information against.

2.3 The Taskforce's recommendations set out how companies across sectors and geographies can assess and disclose their governance, strategy, risk management and metrics and targets related to climate change. The aim of this instrument is to require these disclosures to promote the management of climate-related financial risk and opportunities across our economy and financial system.

2.4 This instrument forms part of wider efforts to make climate-related financial disclosures mandatory across the UK's economy as set out in the HM Treasury-led TCFD Taskforce's Interim Report and accompanying Roadmap[1].

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is England, Wales and Scotland. It will also extend by agreement to Northern Ireland.

4.2 The UK Government is responsible for the operation and regulation of business entities in England and Wales, and in Scotland. The Northern Ireland administration has agreed that, while the operation and regulation of business entities remains a transferred matter within the legislative competence of the Northern Ireland Assembly, amendments to the Companies Act 2006 and legislation regulating

[1] https://www.gov.uk/government/publications/uk-joint-regulator-and-government-tcfd-taskforce-interim-report-and-roadmap

business entities should be made in the same terms for the whole of the United Kingdom.

5. European Convention on Human Rights

5.1 Lord Callanan has made the following statement regarding Human Rights:

"In my view the provisions of the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2021 are compatible with the Convention rights."

6. Legislative Context

6.1 The Regulations amend sections 414C, CA and CB Companies Act and will be made under the powers set out in section 468 Companies Act 2006.

6.2 The Regulations define "climate-related financial disclosures" and require relevant companies to make the disclosures in their strategic report.

6.3 The Regulations will come into force on 6th April 2022.

6.4 It is anticipated that a set of related regulations[2] which will apply to LLPs will also commence on that date. It is anticipated that the LLP regulations will be made after the Regulations and under the negative resolution procedure. The LLP regulations will apply the requirement to make "climate-related financial disclosures" to relevant LLPs with appropriate modifications. The further set of regulations will do this using the powers which are set out in sections 15 and 17 of the LLP Act 2000, and by amending the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 (S.I. 2008/1911).

7. Policy background

What is being done and why?

7.1 In 2015, the Financial Stability Board created the Task Force on Climate-related Financial Disclosures (TCFD) to improve and increase reporting of climate-related financial information. In 2017, the Task Force published its final report which included a set of voluntary disclosure recommendations on how companies across sectors and geographies could assess and disclose their governance, strategy, risk management, and metrics and targets related to climate change, and disclose to markets and other stakeholders their climate-related risks and opportunities.

7.2 The UK Government's 2019 Green Finance Strategy set out an expectation that all listed companies and large asset owners should disclose in line with the TCFD recommendations by 2022. Alongside this expectation, a cross Government and regulator taskforce was set up to consider the appropriateness of introducing mandatory reporting requirements across the economy. The outcome of the taskforce was the Chancellor's November 2020 commitment for the UK to become the first G20 country to require mandatory TCFD-aligned climate-related financial disclosures across the economy by 2025, with most requirements to be in place by 2023.

7.3 In order to support the UK's transition toward net zero, the introduction of new reporting requirements aligned to the TCFD recommendations for certain companies and LLPs are necessary to ensure that such entities with a material economic or

[2] The Limited Liabilities Partnerships (Strategic Report) (Climate-Related Financial Disclosure) Regulations 2021

environmental impact or exposure assess, disclose and ultimately take actions against climate-related risks and opportunities. Accordingly, such disclosure is intended to significantly increase the proportion of companies taking such actions which, in turn, will provide investors with more of the information they need to adequately understand and manage climate-related financial risks and provide other stakeholders with a greater level of information on climate-related matters.

7.4 Whilst there has been a great deal of support for the TCFD framework, levels of disclosure overall are low and many companies are often not disclosing in line with all of the TCFD recommendations. Accordingly, regulatory action is needed in order to require relevant disclosure to ensure that all UK companies above certain thresholds give due consideration to climate change in risk assessment and decision making while providing a good level of information to financial markets and other interested parties.

7.5 The regulations will require certain companies to report climate-related financial information in the Non-Financial and Sustainability Information statement which forms part of the Strategic Report. The information to be disclosed will be descriptions by the company of the climate-related risks and opportunities it identifies as material for its business; its governance and risk management approaches to these; how these risks and opportunities impact its strategy and business model; and the targets and performance indicators it applies to managing them.

7.6 The regulations will apply these disclosure requirements to companies which meet the following criteria:

(a) UK companies currently required to produce a non-financial information statement, being companies which have more than 500 employees and have transferable securities admitted to trading on a UK regulated market, banking companies or insurance companies ('Relevant Public Interest Entities');

(b) UK registered companies with securities admitted to the Alternative Investment Market of the London Stock Exchange with more than 500 employees; or

(c) UK registered companies which are not included in the categories above, which have more than 500 employees and a turnover of more than £500m.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

9. Consolidation

9.1 The Department does not intend to consolidate this instrument into the relevant legislation.

10. Consultation outcome

10.1 The Government consulted on proposals from 24th March 2021 for a 6-week period. 137 formal responses were received from a wide range of stakeholders including companies, financial institutions, civil society bodies and trade associations. Feedback showed broad support for the policy. Given the widespread support, the majority of the policy is being implemented as consulted on. Two changes were made following

the consultation – the first being the inclusion of a qualitative scenario analysis requirement, and the second being closer alignment between the wording of the draft regulations and the language of the 11 TCFD recommendations. A link to the Government response to the consultation can be found here.

11. Guidance

11.1 The Government is publishing a set of non-binding Q&A guidance alongside these Regulations. Guidance on these Regulations and the LLP Regulations will be published once the regulations have been made. The Q&A guidance is intended to support in scope companies and LLPs in their application of the relevant regulations.

12. Impact

12.1 The combined impact on business of these Regulations and those which apply to LLPs is £145.3m (net cost to business per year, in 2019 prices), based on the additional reporting costs to groups of companies that would fall in scope of the incoming requirements. This figure would include the cost of disclosing their governance, strategy, risk management processes and metrics and targets. A significant number of charities or voluntary bodies will not be captured within the scope of the Regulations. The impact on these bodies is captured in the associated Impact Assessment.

12.2 There is no significant impact on the public sector other than assuming the cost of producing guidance.

12.3 A full Impact Assessment is submitted with this memorandum and published alongside the Explanatory Memorandum on the legislation.gov.uk website.

13. Regulating small business

13.1 The legislation does not apply to activities that are undertaken by small businesses.

14. Monitoring & review

14.1 The Government will monitor how companies respond to the amendments made in this instrument.

14.2 A statutory review clause is included in the instrument to review the regulations before 6th April 2027 with subsequent reports published at intervals not exceeding five years.

15. Contact

15.1 Amy Jenkins at the Department for Business, Energy and Industrial Strategy (amy.jenkins@beis.gov.uk) can be contacted with any queries regarding the instrument.

15.2 Andrew Death, Deputy Director for Corporate Reporting, at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.

15.3 Lord Callanan at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.