ClientEarth

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FCA Engagement Papers 1-4: New regime for public offers and admissions to trading

ClientEarth comments

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Background and key recommendations

ClientEarth is a charity that uses the power of the law to protect people and the planet. We are international lawyers finding practical solutions for the world's biggest environmental challenges. From our offices in London, Brussels, Warsaw, Berlin, Madrid, Beijing, Luxembourg and Los Angeles, we work on laws throughout their lifetime, from the earliest stages to implementation and enforcement.

ClientEarth's Accountable Finance initiative analyses the legal duties of a wide spectrum of actors in the financial system – including regulators, companies, investors, banks, insurers, pension schemes and asset managers – to consider, manage and report their risks and impacts associated with climate change and the environment.

We welcome the opportunity to provide our views on the FCA's proposed requirements for issuers seeking to have securities admitted to trading on regulated markets under the new public offers and admissions to trading regime, as set out by the FCA in its Engagement Papers.[1]

This response sets out four key recommendations:

No.	Engagement Paper	Recommendation
1	EP1	Introduce mandatory sustainability disclosure requirements at the point of listing which are aligned with the TCFD / ISSB / transition plan disclosures required for listed companies.
2	EP1	(A) Include additional disclosure requirements for "mineral companies" in the new regime; and (B) reform Competent Person's Report requirements and associated disclosures to ensure that fossil fuel companies consider and disclose to investors: (i) the atmospheric viability of their reserves; and (b) the broader impact of climate risk and low carbon transition on the viability of their reserves.
3	EP4	Implement the above recommendations in the debt market where applicable.
4	EP4	Include new disclosure requirements for bond prospectuses of labelled bonds. The approach should include requirements broadly in line with those proposed at EP4; para 60-62, as well as disclosure of issuer-level covenants linked to transition plans created in line with the Transition Plan Taskforce disclosure framework.

We consider our proposals in relation to sustainability disclosures at the point of listing and in bond documentation to represent a necessary and proportionate response by the FCA to the unprecedented risks posed by the climate crisis and nature loss to investors' interests and the stability of financial markets - risks which have recently been shown to be chronically underestimated in the economic models used by the financial sector.[2] It is widely understood that climate risk, interlinked risks related to nature and biodiversity loss, the transition to a low carbon economy, the UK's climate commitments, and the changes companies commit to make in response, are material to investors. This has been explicitly recognised by FCA on many occasions[3].

Fossil fuel companies that continue to pursue new development projects, despite clear and authoritative statements that such projects are incompatible with achieving the climate goals enshrined in the Paris Agreement[4], not only put UK climate commitments in jeopardy, but face particularly acute risks of their assets becoming "stranded". Additional disclosure requirements for these companies are justified to protect investors' interests.

In 2022, the largest IPO on the LSE was the IPO of Ithaca Energy plc, a North Sea oil and gas producer with interests in the most significant development projects in the region. Although fossil fuel companies

[1] See New regime for public offers and admissions to trading | FCA.
[2] See Institute and Faculty of Actuaries and the University of Exeter, '*The Emperor's New Climate Scenarios: limitations and assumptions of commonly used climate-change scenarios in financial services*' (2023).
[3] See, for example, TN801.2, which states in relation to existing listing and disclosure rules: "*Climate-related risks and opportunities are widely understood to be financially material to many issuers' assets and therefore may need to be disclosed […] For instance, in the context of the UK Government's target to achieve net-zero carbon emissions by 2050 and to achieve the goals of the Paris Agreement more generally, many companies are likely to need to consider significant changes to their business. Such changes may be material to an investor's assessment of the prospects of the company and the risks and opportunities shaping it*."
[4] For example, the International Energy Agency stated in its 2021 *World Energy Outlook* report that in the only scenario in which global warming is limited to 1.5 degrees C, "*no new oil and natural gas fields are required beyond those that have already been approved for development*" (see p.100).

do not account for the majority of capital raised through IPOs on the LSE, this listing highlights the current real-world relevance of implementing appropriate disclosures for such companies, which adequately safeguard investors interests and the functioning of the market. In our view, this is essential for the FCA to deliver against its strategic and operational objectives. It is also incumbent upon the FCA to consider how its approach to the reforms covered in the Engagement Papers may contribute to climate and nature transition in the context of the Secretary of State's obligations under the Climate Change Act 2008 and the Environment Act 2021, pursuant to the regulatory principles introduced in Section 27 of the Financial Services and Markets Act 2023.

We also consider our proposals to be consistent with the competitiveness and growth objective introduced in the Financial Services and Markets Act 2023. In relation to the FCA's proposed reform of the UK's equity listing regime, influential UK investors recently highlighted the importance of the "*UK's reputation and attractiveness as the world's 'quality' market, and its role as a beacon for high corporate governance standards and robust investor protections*", and cautioned against rolling back fundamental investor protections and reducing the standards expected of listed companies in the name of the competitiveness of the UK as a listing destination.[5] The letter emphasises that the attractiveness of UK capital markets depends on the attractiveness of UK listed companies to well-informed, long-term investors. This, in turn, depends on the high corporate governance standards and investor protections provided in UK regulation. Therefore it cannot be assumed that an overly flexible or permissive approach to the issues covered in the Engagement Paper would enhance the attractiveness of the UK capital markets. Rather, the FCA must develop an effective and proportionate approach to the risk presented by the climate and nature crisis which is apt to protect the interests of investors and support the UK Government's sustainable finance objectives. Our proposals are in line with this approach.

The importance of existing rules

In ClientEarth's view, the FCA already has a wide range of powers available to it under existing rules which, if properly understood, and applied rigorously and consistently, could be used to manage the unique risks presented by climate change and fossil fuel company listings to great effect. These rules include discretionary powers available to protect investors from detriment, the FCA's control over the prospectus approval process, and the ability of the FCA to publish guidance on transactions considered to represent a high risk of investor detriment. Our comments in relation to the proposals set out in the FCA's engagement papers are made without prejudice to our interpretation of the existing rules or the FCA's obligations in this area, and we maintain our position that the FCA can and should do more with its existing powers to further its strategic and operational objectives.

However, we welcome the FCA's appetite for reform in this area and the comments we have provided are intended by way of a constructive contribution to the development of new rules that further support the FCA's ability to address the implications of climate change for UK capital markets.

We note the FCA's intention, following analysis of the responses to the Engagement Papers, to develop specific rulemaking proposals for consultation during 2024. We assume that the rules cannot be expected to take effect before 2025. Given the inevitably extended timeline for the introduction of new rules, an adequate understanding and application by the FCA of its existing powers and duties is all the more important.

[5] See the letter to the FCA dated 28 June 2023 from UK pension manager Railpen and nine other UK pension schemes representing £300 billion in AUM on behalf of 22 million members, regarding the FCA's proposed listing reforms. The letter, which is available here, was covered in Responsible Investor, here.

Sustainability disclosures at the point of listing

Please consider this section a response to question 7(c) and paragraphs 37-83 of EP1.

Recommendation 1. The FCA should introduce mandatory sustainability disclosure requirements at the point of listing which are aligned with the disclosures required for listed companies pursuant to rules implementing: (a) TCFD-related disclosures; and in the future (b) ISSB disclosures; and (c) transition plan disclosure requirements.

Rationale

We welcome FCA's observation that "*it is at least as important that investors have a clear understanding of the ESG issues faced by companies at the point at which the company seeks admission to a regulated market",* its recognition that *"there is an information asymmetry between issuers and the market at the point at which an issuer first seeks admission to public markets, with investors potentially having much less visibility on the ESG risks and opportunities faced by the issuer",* and its acknowledgement of the harm this may cause *"by making it harder to price securities accurately, and by affecting capital allocation decisions."* (EP1; para. 72).

This directly implicates the FCA's strategic and operational objectives because, as noted in Engagement Paper 1, "*such outcomes would be detrimental to market effectiveness, transparency and the efficient allocation of capital. Investors may suffer losses and mispricing may reduce market confidence. Further it is possible that if investors are not confident about the effectiveness of regulatory requirements they may discount a stock, reducing the value of securities listed on UK markets*." (EP1; para. 11).

It is clear that existing disclosure requirements are not sufficient to close the information gap identified by the FCA. General disclosure requirements for the prospectus, and other specific disclosure requirements such as risk factor disclosures, in principle can and should be applied so that material sustainability-related risks are adequately and fairly presented to the readers of the prospectus. However, even if such requirements were: (a) properly understood; (b) applied rigorously and consistently; and (c) and met by applicants in practice, they may not result in disclosures with the specificity and granularity necessary to meet the information needs of the readers of the prospectus. These needs have been recognised in the development of specific ongoing disclosure regimes for listed companies, but have not as yet been reflected in disclosure requirements at the point of listing.

We recognise, from our own experience of using and scrutinising prospectus disclosures, the barriers to adequate sustainability disclosure under existing rules identified by the FCA in EP1, including that:

- "*companies may find it difficult to identify the relevant information to disclose, or to understand the level of detail required or expected. ESG reporting standards are relatively new compared to more traditional financial reporting, and companies may therefore find it difficult to interpret the requirements without more specific guidance*". (EP1; para. 74)
- "*companies may differ in their assessment of the materiality of information to their business and may not produce consistent disclosures, even for issuers with similar business models. This could in turn limit the usefulness of these disclosures to investors*". (EP1; para. 74)
- "*this approach [i.e. relying on the interpretation of existing prospectus disclosure requirements] also requires the FCA to apply judgement as to an appropriate level of detail, which offers less*

> *certainty to issuers and sponsors (where relevant) and may result in more rounds of comment on prospectuses prior to approval*." (EP1; para. 75).

These limitations make it essential that the FCA takes this opportunity to introduce new specific sustainability disclosure requirements at the point at which companies apply to list to correct the observed information asymmetry at the point of listing, which will in turn protect market effectiveness and allow investors to make fully informed allocation decisions.

Moreover, as we have previously suggested[6], the FCA has most leverage over companies while they are applicants for listing – i.e. before they have gained access to capital through the UK financial markets. It is incumbent upon the FCA to seek ways use this leverage to: (i) deliver against its strategic and operational objectives; (ii) meet Treasury's recommendation[7] to the FCA to have regard to the government's "*ambitions for the provision of sustainable finance*" when considering how to advance its objectives; and (iii) contribute to the government's pathway to a Net Zero-aligned Financial Centre as set out in the March 2023 Green Finance Strategy[8].

After this point in the company lifecycle it is much harder for the FCA to impose corrective action through supervision and enforcement even where disclosures are defective in ways that put investors' interests at risk. Ongoing climate-related disclosures by listed companies are of very uneven quality. This is the case for both: (i) climate risk disclosures under long-standing financial and non-financial disclosure rules[9]; and the net zero targets, strategies and transition plans disclosed by companies voluntarily or under emerging rules.[10] In our view, this represents a market failure which puts investors' interests at risk.[11] The FCA recognised similar issues in its July 2022 review of TCFD disclosures by premium listed companies[12], concluding that:

> "*We found some instances where companies indicated that they had made disclosures consistent with the recommended disclosures, but the disclosures themselves appeared to be very limited in content. We are considering these in more detail and may take action as appropriate*.
>
> […]
>
> "*Our own analysis found the number of companies within the population of our review making [net zero] commitments to be much higher, with 80% of listed companies making a net zero commitment […] We carried out further analysis on the content of some of those commitments*

[6] See ClientEarth's July 2022 Position Paper on the UK Listing Rules and Climate Change, available here.
[7] Communicated in HM Treasury, '*Recommendations for the Financial Conduct Authority*' (December 2022), available here.
[8] See Chapter 2 of the UK Government's '*2023 Green Finance Strategy: Mobilising Green Investment*' (March 2023), available here.
[9] ClientEarth's 2021 'Accountability Emergency' report (available here). found that for the 250 largest companies listed on the main market of the LSE, just 4% made a clear reference to climate change-related factors in their financial accounts and only 4% of audit reports provided a clear explanation about whether the auditors had considered climate change-related factors. Only 40% of companies clearly referred to climate change in their discussion of principal risks and uncertainties, and many of the companies that did disclose used high level 'boilerplate' language to describe climate-related risks and impacts. Of the minority of companies (31%) that disclosed GHG emissions reduction targets, many omitted meaningful detail about assumptions, methodologies and strategies related to the targets.
[10] The New Climate Institute's 2023 'Corporate Climate Responsibility Monitor' report (available here) concluded that "*most companies' climate strategies are mired by ambiguous commitments, offsetting plans that lack credibility and emission scope exclusions*." The climate strategies of 15 of the 24 companies reviewed were assessed to be of low or very low integrity. Climate pledges for 2030 fell well short of the economy-wide emission reductions required to stay below the 1.5°C temperature limit.
[11] As explained in more detail in the '*Key points and General Comments*' of ClientEarth's February 2023 response (available here; see p.2) to the Transition Plan Taskforce's recent consultation on its sector-neutral framework for private sector transition plans.
[12] The FCA's July 2022 review of TCFD disclosure by premium listed companies is available here.

> *and observed that these were often not clear and in some cases they risked being misleading as a result*."[13]

However, we have not seen evidence of systematic regulatory enforcement apt to address the market failure observed in relation to ongoing disclosures.

Imposing appropriate and proportionate requirements at the point of listing is therefore a vital opportunity for the FCA to safeguard the quality of sustainability-related disclosures made by listed companies at the outset of their participation in the UK's capital markets.

Materiality, relevance and proportionality

Introducing sustainability disclosures at the point of listing aligned with the TCFD, ISSB and transition plan disclosures required by listed companies would result in the provision of information that is known to be *material, relevant and decision-useful* to investors at a crucial point for investment decision-making.

The materiality of this information to investment decision-making is widely recognised, including by the UK Government and regulators. The Government's March 2023 Green Finance Strategy, for instance, states in para. 13 that consistent and comparable sustainability information:

> "*allows asset owners to better understand which projects will have the greatest positive climate impact; it enables financial firms to lend or borrow money based on a timely and accurate assessment of climate and nature risks; and it empowers companies themselves to better tell their stakeholders how they will reach their climate and environmental objectives. Ultimately, more information should lead to more accurate pricing in markets*."

Similarly, the FCA has recognised that:

> "*more structured [climate] disclosures and greater transparency by listed companies will support market integrity and should lead to better informed decisions as well as more accurate asset pricing. This, in turn, should support efficient capital allocation in the transition to a net zero economy*."[14]

These statements are recent, but the materiality of climate, nature and biodiversity and other sustainability information to investors has been clear for a long time. For example, the investor-led Climate Action 100+ initiative, which coordinates action to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change now has 700 investor signatories responsible for more than $68 trillion of assets under management.[15] The Institutional Investors Group on Climate Change, which has over 400 members representing $65 trillion in assets[16], has advocated for many years on the relevance of climate-related risk and opportunities for investors.[17] Asset owner signatories to the UN Convened Net-Zero Asset Owner Alliance, of which there are currently 86, representing $11 trillion in assets under management[18], explicitly recognise that:

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[13] The FRC reached a similar conclusion in its complementary July 2022 review of listed company TCFD disclosures (available here; see p. 9).
[14] See Primary Market Bulletin 42, available here.
[15] See Investors | Climate Action 100+.
[16] See Our members (iigcc.org).
[17] See, for example, the November 2010 Global Investor Statement on Climate Change: Reducing Risks, Seizing Opportunities & Closing the Climate Investment Gap, available here.
[18] See Members – United Nations Environment – Finance Initiative (unepfi.org).

> "*in order to meet our fiduciary duty to manage risks and achieve target returns, this Commitment [to transition investment portfolios to net-zero GHG emissions by 2050] must be embedded in a holistic approach to managing sustainability considerations, incorporating but not limited to, climate change, and must emphasize GHG emissions reduction outcomes in the real economy*."[19]

In relation to nature and biodiversity risk, The World Economic Forum estimates that as much as half of global GDP ($44 trillion) is moderately or highly dependent on nature and its services.[20] Not only is nature essential for human wellbeing and survival but it also provides significant economic value and presents material financial risks for companies and investors if degraded. The Network for Greening the Financial System has recognised that nature-related risks and biodiversity loss "*could have significant macroeconomic implications, and that failure to account for, mitigate, and adapt to these implications is a source of risks for individual financial institutions as well as for financial stability*."[21] In a statement in support of the adoption of an ambitions Global Biodiversity Framework in December 2022, 154 private financial institutions representing over $24.8 trillion in assets under management endorsed a statement drafted by UNEP FI, UN PRI and the Finance for Biodiversity Foundation recognising the financial materiality of biodiversity loss, the implications for fiduciary duty and investment decision-making and the need for the financial sector to work to address nature-related risk alongside public financial institutions.[22]

The same logic is built into the rationale behind climate and sustainability disclosure regimes including TCFD, ISSB, the EU Corporate Sustainability Reporting Directive, emerging requirements for transition plan disclosure, and the recently launched TNFD, which are all aimed at improving the comparability and comprehensiveness of climate and sustainability information reported to stakeholders so that it is decision-useful. As noted by the FCA in Engagement Paper 1, the rationale for the provision of this information is equally strong at the point of listing.

These frameworks also represent a huge international multi-stakeholder effort to derive appropriate standards in sustainability disclosure, and carefully balance the needs of users with the burden of additional disclosure for companies, including by reference to judgements about "materiality" which may in some cases limit the information an entity is required to disclose. We therefore urge the FCA to leverage the balance struck in the development of these frameworks by incorporating them into its proposals for additional requirements and guidance regarding sustainability disclosures at the point of listing, as suggested in paragraph 78 of EP 1.

We particularly welcome, and agree with wholeheartedly, the FCA's observation that "*if these requirements are aligned with what issuers would later be required to produce in the annual report, the additional burden [on companies] could be minimised*" (EP1; para. 78). For a company seeking listing, the effect of introducing aligned requirements at the point of listing would likely be to accelerate by one reporting period the obligation to provide appropriate sustainability disclosures. In light of the general expectation that applicant companies (and their directors) develop the procedures, systems and controls necessary for the company to meet ongoing listing requirements[23], we would suggest that this is a

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[19] See p.2 of the Net- Zero Asset Owner Alliance Commitment Document for Participating Asset Owners, available here.
[20] See p. 8 of the World Economic Forum's report *Nature Risk Rising* (2020), available here.
[21] See the NGFS *Statement on Nature-Related Financial Risks* (2022), here.
[22] See *'Moving together on nature': statement from the private financial sector to the conference of the parties to the Convention on Biological Diversity* (2022), here.
[23] Listing Principle 1 requires a listed company to "*take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations*." (see LR 7.2.1R and LR 7.2.2G). See also LR 8.4.2 and 8.4.3: at

reasonable and proportionate enhancement of the disclosure regime. Given the careful calibration of these rules that has already been undertaken, any decision to deviate and reduce the disclosures required at the point of listing in the interests of proportionality (which could in principle deprive investors of decision-useful information) would need to be specifically and rigorously justified by the FCA in its rulemaking and should be approached with caution.

Rules versus guidance

Although the precise level of prescription may need to be evaluated, it is essential that content requirements for sustainability disclosures at the point of listing are introduced through mandatory rules rather than guidance which may or may not be followed by applicants in practice (see EP1; paras. 77-79).

As noted above, disclosure of net zero targets, strategies and transition plans under voluntary frameworks currently represents a market failure, which is seriously detrimental to investors' interests. In its 2023 'Corporate Climate Responsibility Monitor' report, the New Climate Institute found that the climate strategies of 15 of the 24 companies surveyed were of low or very low integrity, and that "*their combined emission reduction commitments are wholly insufficient to align with 1.5°C-compatible decarbonisation trajectories; targets and potential offsetting plans remain ambiguous; and the exclusion of emission scopes severely undermines the targets of several companies*".[24] This market failure creates the potential for greenwashing and transition "in name only" under the guise of inadequate corporate "net zero" commitments. It limits the ability of investors to manage climate risk and make fully informed financial decisions and impedes genuine transition to a low-carbon economy.

Binding regulation is required both to correct this market failure in ongoing disclosures and to avoid similar market failure at the point of listing. In the context of the listing and prospectus rules specifically, the FCA has already issued guidance[25] stressing that "*climate-related risks and opportunities are widely understood to be financially material to many issuers' assets and therefore may need to be disclosed [under existing listing and prospectus rules]*". However, as the FCA recognises in Engagement Paper 1, guidance of this nature has not been sufficient to ensure adequate sustainability-related disclosure at the point of listing under existing rules, and that a range of barriers to effective, comparable disclosure remain (see EP1; para. 74). More voluntary guidance at the same level will not overcome these barriers. Nor will it ensure the provision of the comprehensive and comparable sustainability information needed by investors.

There is recent survey-based evidence that a majority of *investors* consider that current (voluntary) disclosures are uninformative and do not enable fully informed climate-related investment decisions, and that standardised and mandatory reporting on climate risk is necessary.[26] This evidence should be considered by the FCA when it evaluates the need for binding content requirements, alongside any specific representations made in response to Engagement Paper 1.

In addition, the UN High Level Expert Group on the net-zero commitments of non-state entities (**UN HLEG**) has stressed the importance of binding regulation, noting that binding regulation is essential to

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the time of a premium listing, the sponsor is required to submit a declaration to the FCA confirming (among other things) that it is of the reasonable opinion that the directors of the company have established procedures which enable the company to comply with the listing rules, disclosure requirements and transparency rules on an ongoing basis.

[24] See p.5 of the New Climate Institute's 2023 'Corporate Climate Responsibility Monitor' report (available here).

[25] See the FCA's TN801.2, available here.

[26] See Ilhan, Krueger, Sautner and Starks, 'Climate Risk Disclosure and Institutional Investors' (The Review of Financial Studies, 9 January 2023), available here.

"*level the playing field and transform the groundswell of voluntary [net zero] commitments into ground rules for the economy overall*". UN HLEG recommends further that "*in order to ensure rigour, consistency and competitiveness, regulators should develop regulation and standards in areas including net zero pledges, transition plans and disclosure.*"[27]

UN HLEG also highlights the benefits of binding net zero regulation for markets: it can "*bring enormous benefits by establishing clear, enforceable standards that apply to all, limiting potential for greenwashing and removing the risk that laggards will take market share from leaders. Net zero regulations also create new markets by driving innovation, and represent a significant opportunity for governments to accelerate implementation of their commitments under the Paris Agreement*."[28] The FCA has a crucial opportunity to recognise these conclusions and enact transformative rules for the UK listing regime, and we urge the FCA in the strongest terms to introduce mandatory reporting requirements rather than voluntary guidance.

[27] See p.33 of the November 2022 UN HLEG 'Integrity Matters' report (available here).
[28] See FN27.

Mineral company disclosures

Please consider this section a response to question 7(c) and paragraphs 37-83 (in particular paragraph 80) of EP1.

Recommendation 2. (A) Include additional disclosure requirements for "mineral companies" in the new regime; and (B) reform Competent Person's Report requirements and associated disclosures to ensure that fossil fuel companies consider and disclose to investors: (i) the atmospheric viability of their reserves; and (ii) the broader impact of climate risk and low carbon transition on the viability of their reserves.

Rationale for addressing the position of "mineral companies"

The FCA rightly questions "*whether and how to differentiate across sectors in any requirements or guidance*" (EP1; para. 80), but does not currently address the position of so-called "specialist issuers" other than in Engagement Paper 3 (para. 30). It is essential that the FCA considers its approach to such companies in the context of the current reform of listing and prospectus rules, and enhances the additional information required to be disclosed by such companies, to ensure that it is sufficient to enable investors to make fully-informed investment decisions.

The FCA currently requires additional information in the prospectus from "specialist issuers" including "mineral companies" involved in oil, gas or coal projects, under Article 39 of the UK Prospectus Delegated Regulation.[29] The additional information required from such "mineral companies" is specified in Part III.2 of the FCA's Technical Note TN619.1.[30]

Under para. 131(c) of the Technical Note, "*Evaluation of mineral projects is presumed to be necessary for an informed assessment of the prospects of the issuer in a number of instances [including]:*

- *where the projects seek to extract minerals for their re-sale value as commodities and there exists uncertainty as to the quantities of* ***economically*** *recoverable resources or the* ***technical*** *feasibility of their recovery*."

We return to the implications of the focus on economic and technical feasibility (and the neglect of climate and environmental constraints) below.

The information required from mineral companies includes:

- details of the company's mineral resources and reserves, together with exploration prospects, progress and results, licence terms, economic and environmental conditions and an explanation of any "exceptional factors" that have influenced these matters (TN619.1; para. 132);
- a competent person's report (**CPR**) dated not more than 6 months from the date of the prospectus reporting certain details related to the company's mineral resources, reserves and exploration prospects and their viability (TN619.1; para. 133). The CPR must:
    - be prepared by an independent professional of good standing who meets applicable professional codes / standards (TN619.1; para. 133(i)(a));

[29] Commission Delegated Regulation (EU) 2019/980 UK version, Article 39.
[30] The FCA's Technical Note TN619.1 is available here.

- report the company's mineral resources, reserves and exploration results / prospects in accordance with the reporting standards / codes of the organisations listed in Appendix I of the Technical Note (TN619.1; para. 133(i)(c)); and
- contain information on the company's "mineral projects" having regard to the information set out in Appendix II (for mining projects) and Appendix III (for oil and gas projects).

For reasons explained below, the FCA must take this opportunity to enhance these requirements. However, as a preliminary point, it is essential that the FCA replaces these requirements in the context of the new listing and prospectus rules so that they do not fall away as an unintended consequence of the current reforms.

Given the essential role of "mineral companies" in the transition to a low carbon economy and their acute exposure to sector-specific climate-related risks, it is imperative that these information requirements are maintained (at a minimum) and enhanced.

Rationale for enhancing the information required from "mineral companies", including the competent persons' regime

Recent research from NGO Carbon Tracker has demonstrated the central role of financial centres and stock exchanges in capital raising by fossil fuel companies. In its 2022 report *Unburnable Carbon: Ten Years On*, Carbon Tracker demonstrated the huge quantity of "unburnable carbon" (i.e. fossil fuel reserves that must stay in the ground if global temperature rise is to be limited to 1.5 degrees C[31]) that is found on a handful of financial centres, many of which have set their own net zero goals. The LSE is one of these key financial centres. According to Carbon Tracker's research, the emissions embedded on the LSE are 30 times greater than those of the UK's own fossil fuel reserves, and ten times the UK's carbon budget for 2023-2037.[32] Investors in these financial centres face concentrated stranded asset risk as a result, while the exchanges themselves facilitate the transactions which support the continued expansion of the fossil fuel industry - transactions that are not only bad for the planet, but generate risk for investors and the stability of markets.

Nevertheless, fossil fuel producers were found to have collectively raised $453 billion of equity investment through thousands of IPOs and additional offerings between 2012 and 2020.[33] The discovered reserves and resources of listed companies increased from 750 to 1,050 GtCO2 between 2011 and 2021[34], far in excess of the remaining carbon budget for a 'safe' climate. For the sake of comparison, as of Augst 2021, only 360 GtCO2 remained of the IPCC's carbon budget for a 66% chance of limiting global warming to 1.5.[35]

In this context of increasing concentrated exposure to assets at severe risk of becoming stranded, a precautionary approach is required to protect investors from the market risk presented by an

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[31] The UN Intergovernmental Panel on Climate Change (**IPCC**) confirmed in 2022 that projected CO2 emissions from existing and planned fossil fuel infrastructure (without additional abatement) will exceed levels consistent with pathways that limit global warming to 1.5°C with no or limited overshoot (see IPCC AR6 WGIII SPM at B.7.). The implication is that many proven fossil fuel reserves must be left in the ground if the world is to stand any chance of meeting its climate goals. A recent study has suggested that in order to limit global warming to 1.5°C, up to 40% of fossil fuel reserves currently under development will need to be left in the ground. See '*Existing fossil fuel extraction would warm the world beyond 1.5 °C*' (Trout et al., 17 May 2022, Environ. Res. Lett. 17). Carbon Tracker's own research suggests that up to 90$ of fossil fuel reserves must remain in the ground, and shows that there are already more fossil fuels listed on global financial markets than the world can afford to burn if it is to prevent dangerous climate change (See '*Unburnable Carbon: Ten Years On*' (2022)).

[32] See p.12 of Carbon Tracker, '*Unburnable Carbon: Ten Years On*' (2022).

[33] See Carbon Tracker, '*A Tale of Two Share Issues: how fossil fuel equity offerings are losing investors billions*' (2021).

[34] See p.10 of Carbon Tracker, '*Unburnable Carbon: Ten Years On*' (2022).

[35] See Carbon Brief, '*Analysis: What the new IPCC report says about when world may pass 1.5C and 2C*' (2021).

accumulation of "unburnable carbon" on UK capital markets. At a minimum, it is essential that potential investors have access to appropriate information to make fully informed investment decisions at the point fossil fuel companies seek to raise capital.

The CPR regime is intended to provide an appropriate level of transparency and assurance over the reserves and resources reported to the market by applicants for listing, in light of the distinctive characteristics of "mineral companies" including fossil fuel companies, and the distinctive risks they face. The involvement of independent experts and reference to external verification and reporting standards should, in principle, provide a high degree of protection to investors through independent high quality assurance.

However, the CPR process is currently undertaken with absolutely no regard for the impact of climate change risk, national or international policy responses, economic transition, or remaining carbon budgets on the viability of the commercial extraction of fossil fuel companies' reserves. This makes the process entirely unfit for purpose in today's world. It leaves investors with an unbalanced account of the viability of fossil fuel reserves based only on current market conditions, rather than best estimates of future conditions based on authoritative climate scenarios and the UK's national and international climate commitments and policies.

In order to uphold the FCA's strategic and operational objectives, it is therefore essential that opportunity is taken to reform the CPR process and the other additional disclosures required from fossil fuel companies to give investors a fuller picture of the risks associated with their investment. As explained in more detail below, requiring the CPR to include an assessment of the *atmospheric viability* of a company's reserves (alongside their commercial and technical viability), conducted by a suitably qualified climate expert, would be a significant step in the right direction, and could be achieved by the FCA through proportionate adjustments to the information regime established in TN619.1.

The blindness of the CPR regime to climate risk

As noted above, the current rules require a CPR to include:

- a report of company's mineral resources, reserves and results in accordance with the reporting standards listed in **Appendix I** of TN619.1; and
- information on the company's "mineral projects" based on **Appendix II** (for mining projects) and **Appendix III** (for oil and gas projects).

As explained below, both of these requirements (and the other information requirements in TN619.1) are currently blind to the impact of climate-related matters on the viability of reserves.

Appendix I contains a list of the international third party standards in accordance with which the CPR must be prepared. For oil and gas companies[36], this includes the Petroleum Resources Management System (**PRMS**)[37] published jointly by the Society of Petroleum Engineers, the World Petroleum Council, the American Association of Petroleum Geologists and the Society of Petroleum Evaluation Engineers, as amended, and equivalent standards established in Canada and Norway.

[36] Appendix I also lists applicable codes of practice for reporting by mining companies, including the Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves (the **JORC Code**), and three valuation standards. We do not analyse the JORC code, or other mining or valuation codes, for the purposes of this response, but similar considerations apply as we have identified in relation to PRMS.
[37] PRMS is available here.

In the PRMS, reported resources are categorised according to their ability to be economically extracted and sold. 'Reserves' are defined as "those quantities of petroleum anticipated to be commercially recoverable by application of development projects to known accumulations from a given date forward under defined conditions". Reserves must satisfy four criteria: discovered, recoverable, commercial, and remaining based on the development project(s) applied, and are further categorised based on the certainty of their recovery (see p. 31 of PRMS)

Notably there is no free-standing climate requirement for a given discovery of petroleum to be counted as reserves, as the focus is purely on commercial recovery, rather than whether the reserves can be extracted within estimated carbon budgets, credible emission reduction pathways or national policy scenarios.

The recoverability of reserves is primarily a geological and technical assessment based on the ability to access reserves using available technology. The commerciality of the reserves is then assessed on top of the primary recoverability test.

The commerciality of a project depends on a number of "defined conditions" which have to be assessed. These include issues such as "*economics (e.g., hurdle rates and commodity price); operating and capital costs; and technical, marketing, sales route, legal, environmental, social, and governmental factors*" (see p.40 of PRMS). PRMS also acknowledges the existence of "*modifying factors that may additionally influence investment decisions, such as contractual or political risks [and] should be recognized so the entity may address these factors if they are not included in the project analysis*" (p.17 of PRMS). Theoretically, these conditions and factors are broad enough to include an assessment of the impact of carbon budgets, stranded asset risk and national climate policies on the commerciality of a project. However, there is no explicit requirement to consider climate-related matters in the assessment[38], and our understanding is that PRMS is not routinely interpreted this way in practice.

Similarly, the PRMS guidance on net cash-flow evaluation (one method that may be used to determine the value of a project) could theoretically be applied in a way that takes account of the impact of climate-related factors on commodity price assumptions, demand assumptions and other economic factors, but there is no specific requirement to this effect.

Appendix III sets out other information that should be addressed in the CPR for oil and gas companies[39] including: a legal and geological overview of the company's exploration rights and properties, a breakdown of the company's reserves and resources, a valuation of the company's reserves, an assessment of certain environmental and facilities factors, and any additional information required for a proper appraisal of any "special factors" affecting the exploration or extraction business of the company.

As with the requirements of PRMS, a description of climate-related factors affecting the company's reserves and resources arguably could, and should, already be provided under various heads of disclosure set out in Appendix III. For example, a description of the "*principle assumptions on which the valuation of proved and probable reserves is based*" (para. (iv)(2)) and "*information to demonstrate the sensitivity to changes in the principal assumptions*" (para. (iv)(3)) could include a description of the climate-related assumptions adopted in the valuation, the anticipated impact of climate-related matters on demand and price assumptions and an analysis of the sensitivity of the valuation to assumptions aligned with the achievement of the Paris Agreement temperature goals globally. The description of

[38] The word "climate" does not appear in PRMS.
[39] Appendix II sets out corresponding disclosures for mining companies. Although we have not commented on these in this response, similar considerations apply.

“special factors” required under para. (ix) arguably should entail a description of climate transition risk associated with the companies reserves, including the risk that the reserves may become “stranded” due to the international policy response to climate change and related changes in regulation, demand, pricing etc. However, there are no explicit requirements to this effect.

Overall, the absence of a specific and explicit treatment of climate change in these requirements results in an unbalanced and inconsistent picture being presented to investors by applicant companies – one that gives undue precedence to “business as usual”, on the assumption that the world will fail to transition away from fossil fuels, despite the overwhelming international consensus that transition is required, and the wealth of analysis regarding the implications of transition for the fossil fuel sector. Despite the purpose of the CPR and the other additional disclosures required from fossil fuel companies in TN619.1, this leaves investors blind as to the true financial risk related to their investment because the impact (or potential impact) of climate-related risks and the global transition to a low carbon economy are unaccounted for in the reporting or, at best, dealt with inconsistently by different companies in a way that impedes meaningful comparison.

Testing atmospheric viability and other suggestions for reform

The FCA must address this imbalance through proportionate changes to the disclosure regime to ensure that climate-related matters are taken into account.

Atmospheric viability

Crucially, the tests of whether reserves are recoverable and commercial in the CPR and related disclosures **must take climate constraints into account**. We recommend the inclusion on an additional test in the CPR regime so that, in addition to demonstrating that reserves are (a) technically recoverable; and (b) commercially producible; applicant companies must demonstrate (c) the ***atmospheric viability*** of their reserves.

This additional test would require the company to demonstrate how and why it reasonably considers:

(a) there to be space in the atmosphere for the company’s reserves, once combusted, taking into account the best and most credible scientific estimates of the remaining carbon budget that are available (and projected global demands on it), and a scientific assessment of the likely emissions released once the company’s reserves are combusted; and

(b) that the extraction of its reserves is consistent with credible science-based pathways to limiting global temperature rise to 1.5 degrees C.

This test would be based on a scientific appraisal by a qualified climate expert, by reference to authoritative climate and energy sector scenarios, such as the 1.5 degree C scenarios produced by the International Energy Agency. Issuers would be able to disclose under a range of three scenarios, but would be required to provide justification for the scenarios selected, particularly if they selectively reference “business-as-usual” scenarios, neglect scenarios consistent with 1.5 degrees C of warming, or make reference to less than three authoritative scenarios.

To provide a route to (legally) acceptable disclosure for companies whose reserves are unextractable in these scenarios or inconsistent with progress towards a “safe” climate, such companies should be required to include a clear warning to this effect in their disclosures and disclose the climate / temperature scenarios which *do* permit the extraction of their reserves, together with a scientifically grounded indication of the risk such scenarios entail for the company. If a company’s extraction plans

are consistent with only very high degrees of warming (i.e. those that entail severe physical risk for practically all businesses), this would be reflected in the disclosure of very grave climate-related risks to the company's operations.

This test would provide essential transparency to investors for the first time in the CPR process regarding whether the reserves on which an applicant company's value is based are compatible with global efforts to maintain safe climate. In turn, this allows investors to more fully understand the transition risk faced by the company, including how the company's projections and reserves valuations stack up against authoritative climate scenarios. The enhanced disclosures required in the CPR would feed through into the other financial and risk reporting prepared by the company at the point of listing (as financial and risk reporting in the prospectus would need to be consistent with outlook given in the CPR), with commensurate benefits for the comprehensiveness and comparability of the information presented overall, including transparency regarding the accounting assumptions used by the company.

Other suggestions for reform

To deliver and supplement this new test, the FCA should consider various enhancements to the CPR regime and associated mineral company disclosures in TN619.1 to ensure that climate-related risks, assumptions and dependencies are adequately presented to investors. This could include, for example:

- Integrating the atmospheric viability test as an additional limb of TN619.1 para. 132 by requiring "*an explanation of the atmospheric viability of mineral resources by reference to science-based carbon budgets, to enable an understanding of the expected contribution to global emissions*";
- Amending TN619.1 para. 132(e) to clarify that "exceptional factors" must include a consideration of the influence of climate factors (including atmospheric viability, carbon budgets and the projected impact of transition on demand) on the company's reserves and resources OR adding an additional limb of para. 132 to this effect;
- Amending TN619.1 para. 133 to require the involvement of a qualified climate expert in the preparation of the CPR;
- Supplementing the information required under Appendices II and III to bring climate related matters into account, for example by:
    - Integrating the atmospheric viability test as a new head of disclosure;
    - Requiring an explanation of how the principal assumptions built into the valuation of reserves take climate-related factors, the transition to a low carbon economy and the associated impacts on demand and commodity prices into account, with reference to authoritative scenarios;
    - Specifically requiring the valuation sensitivity analysis to be conducted by reference to a range of credible climate scenarios / temperature pathways;
    - Clarifying that the discussion of "special factors" must include a full explanation of how climate related matters and atmospheric viability have been reflected in the company's presentation of its exploration or extraction business; and / or
    - Adding a freestanding requirement for the company to disclose its key climate-related assumptions and material dependencies, and how these affect the presentation of its reserves and resources.

Possible routes to reform

It is implicit from the discussion above that there are two broad routes to reform in this area for the FCA to consider, which may be pursued in parallel:

1. **Engage with the external standard setters** listed in TN619.1 Appendix I (including PRMS, JORC, VALMIN) to ensure that climate-related factors, including atmospheric viability are properly accounted for in these frameworks. A benefit of this approach would be the ability for the FCA's leadership to stimulate worldwide reform in the presentation of reserves in the CPR, avoiding a jurisdictional "race to the bottom". On the other hand, the FCA has less direct control over these external standards. In any event, the FCA's reliance on external standards in this area which appear not to be fit for purpose in our view raises serious questions regarding the fulfilment of the FCA's strategic and operational objectives, and we urge the FCA to consider the dynamics involved here and the ability of the regulator to ensure that standards relied upon are adequate.
2. **Reform of TN619.1 (or its successor regime)** to incorporate appropriate climate-related disclosures throughout in FCA-controlled legal requirements. As explained above, this could entail relatively straightforward amendments to paras. 132 and 133 and Appendices II and III of TN619.1. Although potentially a more straightforward task in terms of FCA rulemaking, this approach would inherently be more limited to the UK market. Nevertheless, leadership from the FCA in this area would set a valuable international precedent, and direct regulation would limit the ability of companies to avoid the necessary disclosure requirements through their selection amongst the available international frameworks.

Note that, while the comments in this submission related to the main market of the LSE, there is a corresponding need for the LSE to reform the guidance provided to fossil fuel companies in AIM Rule 16[40], where similar considerations apply. Dialogue between the FCA and the LSE on this topic would be valuable.

[40] AIM Rule 16 is available here.

Non-Equity Securities

Please consider this section a response to Engagement Paper 4

Recommendation 3. The FCA should implement our recommendations made above in response to EP1 to the debt market where applicable, as well as to the equity market. In other words, the FCA should:

- Introduce mandatory sustainability disclosure requirements for the prospectus or listing particulars at the point of listing which are aligned with the TCFD / ISSB / transition plan disclosures required for listed companies.
- (A) Include additional disclosure requirements for "mineral companies" in the new regime where applicable to debt securities[41]; and (B) reform Competent Person's Report requirements and associated disclosures to ensure that fossil fuel companies consider and disclose to investors: (i) the atmospheric viability of their reserves; and (b) the broader impact of climate risk and low carbon transition on the viability of their reserves.

Rationale

The FCA should consider the arguments made above in relation to equity listings and prospectuses as they apply in the debt market, which is critical to the financing of the world's highest emitters. As noted above, we consider our proposals to represent a necessary and proportionate response by the FCA to the unprecedented risk posed by climate change to investors' interests and the stability of financial markets - a risk which has recently been shown to be chronically underestimated in the economic models used by the financial sector. It is widely understood that climate risk, the transition to a low carbon economy, the UK's climate commitments, and the changes companies commit to make in response, are material to investors. This has been explicitly recognised by FCA on many occasions. Fossil fuel companies that continue to pursue new development projects, despite clear and authoritative statements that such projects are incompatible with achieving the climate goals enshrined in the Paris Agreement, not only put UK climate commitments in jeopardy, but face acute risks of their assets becoming "stranded". Additional disclosure requirements for these companies, in particular, are justified to protect investors' interests.

Bonds are a key source of funding for companies seeking to expand their coal, oil and gas activities, and therefore at heightened risk from the energy transition.[42] It is widely understood that most of the biggest emitters are mature companies whose dependence on bond issuances for cashflow far outweighs their reliance on the equity markets.[43] These companies represent a heightened credit risk for investors, and our proposals accordingly represent a proportionate response both to the information needs of debt investors and to the FCA's objectives.

Recommendation 4. Include new disclosure requirements for bond prospectuses of labelled bonds. The approach should include requirements broadly in line with those proposed at paragraphs 60-62 of Engagement Paper 4, as well as issuer-level covenants linked to transition plans created in line with the Transition Plan Taskforce disclosure framework.

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[41] TN619.1; para 131, "*debt securities with a denomination of less than EUR 100,000*"

[42] Such companies include the UK listed companies among the Global Coal Exit List (GCEL) and Global Oil and Gas Exit List (GOGEL), whose outstanding USD and Euro bond issuances are shown in the *Toxic Bonds database* (compiled using data from public listings, with cross-verification through the C-bonds database).

[43] Bloomberg, *Greenwashing Enters a $22 Trillion Debt Market, Derailing Climate Goals*, 4 October 2022

Rationale

We welcome the FCA strengthening the connection between the prospectus and bond framework documents through new disclosure requirements (EP4; para. 57) to mitigate the risks arising from material differences in the approaches set out in those documents, including risks of mispricing, greenwashing and undermining trust and the integrity of the market (EP4; para. 54). We also draw the FCA's attention to recent reports of the serious risks arising from ongoing mispricing of climate risk in the bond market: research shows that current prices and credit ratings do not adequately reflect climate data, creating a risk of price adjustments that may either create a long-term drag on portfolios or take effect suddenly, affecting economic stability.[44,45]

As the FCA acknowledges, *"enhanced transparency should prompt issuers to tie the prospectus more closely to wider materials… thus providing investors with valuable, financially material, insights."* Improved disclosure requirements for prospectuses will thus enable more accurate pricing of climate risk, mitigating the resultant risks of portfolio drag and sudden economic shocks.

In Engagement Paper 4, the FCA has outlined two proposals for its approach to new disclosure requirements. The **Second Approach** (EP4; para. 60-62) will be more effective than the **First Approach** (EP4; para.59) in reducing portfolio and systemic risk, but additional requirements should be included for the reasons set out below.

Addressing divergence between the bond framework and prospectus

We note the FCA's guidance in CP21/18 that bond framework documents which form part of a communication relating to an offer or admission of securities are likely to be advertisements for the purposes of the prospectus regime, so must comply with the Prospectus Regulation and the Prospectus RTS Regulation. However, this guidance has limited effect and we share the FCA's continued concerns about potential divergence between the information provided in the prospectus and that described in other documentation such as the bond framework (EP4; para.57). Bond frameworks typically specify more detail than the terms of the bond and legal experts have noted that among the requirements of the voluntary frameworks and standards, there is a lack of engagement with the actual terms of the bond.[46]

The First Approach would not address these concerns: the disclosures it proposes concerning framework alignment to voluntary principles are widely used in labelled bonds already[47] and have failed to prevent the ongoing risks identified by the FCA in EP4. While the voluntary industry principles and guidance set out by ICMA and others provided a useful basis for a nascent market where products were being tried and proven, the labelled bond market is now maturing. The first climate awareness bond was issued in 2007,

[44] Riccardo Rebonato, EDHEC-Risk Climate Impact Institute, EDHEC Business School, *Asleep at the Wheel? The Risk of Sudden Price Adjustments for Climate Risk*, July 2023

[45] Hazel Ilango, Institute for Energy Economics and Financial Analysis, *Rating stability at risk from looming climate downgrades*, 21 August 2023. In this paper, the IEA reported a "*financial time bomb*" in the form of growing and accumulating climate risks which are not accounted for in current credit ratings and will, *"will likely lead to rating volatility and instability, a costly affair for investors and issuers*." The report emphasised the risk to the bond market in particular.

[46] Curtis et al., 2023, *Green Bonds, Empty Promises*, p.49

[47] According to ICMA, its principles were referenced in an estimated 97% of sustainable bonds issued internationally in 2023. See *The Principles announce updated guidance* (icmagroup.org), accessed 19 September 2023

triggering an "explosion" in the green bond market,[48] and the risks of weak, disparate and unenforceable commitments are becoming widespread.[49]

The market-wide risk cannot be addressed by an additional voluntary framework for disclosure. Nor can prospectus disclosure of alignment with voluntary industry principles or guidance, and/or verification by unregulated verifiers, add legal certainty or recourse for the investor in relation to the representations in the framework. As noted above, disclosure of net zero targets, strategies and transition plans under voluntary frameworks currently represents a market failure, which is seriously detrimental to investors' interests.

We therefore recommend the introduction of new disclosure requirements that will provide a clear standard for the market and help to address climate risk at the scale and speed required. The FCA's process for implementing a new regime following this Engagement process, including feedback, specific rule proposals and subsequent consultation next year,[50] is likely to take a minimum of 18 months, during which time the labelled bond market will have continued to expand and mature, and risk to grow.

The First Approach would require merely that the bond issuer disclose the existence – or not – of a bond framework, and whether any such framework: complies with industry principles, has been verified as complying, and will be reviewed. Such disclosure does not align the content of the prospectus with the framework and therefore would not mitigate the risk of the issuer's framework containing representations as to the issuer's green/social/sustainable approach which go beyond the commitments in the prospectus. The disclosure proposed in the First Approach merely points the investor to the framework, and in doing so may make it *more* likely that the investor will misunderstand the nature of the investment by associating the non-contractual representations in the framework with the legally-binding prospectus document.

We also note the broad support, including from investors, reported in Feedback Statement 22/4, for prospectuses to include minimum disclosures on the types of projects and activities for which an issuer will use the proceeds of an offering. The First Approach falls short of requirements for such minimum disclosures, and adoption of that approach would therefore constitute a missed opportunity for the FCA to provide the certainty the market seeks.

We therefore welcome the more specific disclosures set out in the **Second Approach** for use-of-proceeds (UoP) bonds and sustainability-linked bonds (SLBs). However, we recommend that UoP requirements be phrased in terms of *'what'* rather than *'whether'* in order to avoid similar shortfalls to the First Approach. For all labelled bonds, we particularly welcome the suggestion (EP4; para. 62) to prompt issuers to draw links to transition plans created in line with the Transition Plan Taskforce disclosure framework (see our response to EP1 above), which are likely to be material to investor decision-making. Further to this, we recommend that issuers should be required to disclose a 1.5 degree aligned transition plan. Every incremental increase in global temperature beyond 1.5°C above pre-industrial temperatures makes climate impacts more severe and catastrophic tipping points more likely, and gives rise to increased financial risk.

[48] United Nations Department of Economic and Social Affairs and International Platform on Sustainable Finance Input Paper for the G20 Sustainable Finance Working Group, *Improving Compatibility of Approaches to Identify, Verify and Align Investments to Sustainability Goals*, p.21
[49] Curtis et al., 2023, *Green Bonds, Empty Promises*, including at p.56
[50] Indicative timeline from *New regime for public offers and admissions to trading | FCA*, Next Steps, accessed 19 September 2019

The need for contractually binding representations

Legal experts have noted the risk to investors arising from a lack of enforceability of climate-related promises in 'green' bonds (including green, sustainable, social and sustainability-linked bonds),[51] and that green commitments based on frameworks are not sufficient to provide reliable recourse to investors when an issuer fails to fulfil those commitments.[52] The lack of recourse creates potential risk for market participants, including asset owners, who must consider their legal duties in respect of their investment decision-making, and asset managers, who must consider their investment mandates. To effectively link to the framework and prospectus, disclosures should therefore specify whether, and how, sustainability terms are contractually reinforced. The IIGCC has recommended covenants and KPI linked bonds as methods to provide an accountability mechanism for investors during the lifetime of the bond.[53] Covenants can be included in the bond prospectus to attach clear, legal consequences to the UoP and/or the meeting of transition targets.[54] Such terms can aid the accurate pricing of labelled bonds and mitigate the systemic risk of ongoing mispricing in the market.

In practice, such terms lend themselves well to the structure of bond documentation: where an issuer has a base prospectus with an additional final terms document for each bond issuance, issuer-level covenants with transition plan targets should be suitable for the base prospectus, while specific use of proceeds restrictions or payment consequences like step-up coupons would be suited to the final terms of a particular issuance.

Meaningful labelling

The First Approach leaves it open to the issuer of a labelled bond to disclose in the bond prospectus that it has no bond framework, that the bond framework does not comply with industry principles, that the bond framework has not been verified, and/or that it will not be verified. This undermines the use of the label without addressing the risk of an investor purchasing the bond misunderstanding the nature of the investment. We consider that a bond should not be labelled as Green, Social, Sustainable, etc. if the answer to any of the *'whether'* questions in paragraph 59 of EP 4 is 'no', and we would hope that the FCA's new labelling regime will be consistent with this.

In particular, as set out in our response to CP22/20[55] on the FCA's anti-greenwashing rule, firms should ensure not only that their sustainability-related claims are clear, fair and not misleading, but that they must be able to substantiate their claims about sustainability with credible, science-based evidence.

In the context of a bond, this should include the following disclosures in the bond prospectus: the key sustainability terms of the bond framework; a statement as to where the full framework is published with a clear statement of the (lack of) legal status of that framework; confirmation that the bond framework has been independently and expertly verified and by whom; and that ongoing verification will take place of the fulfilment of credible, science-based, 1.5 degree aligned transition targets, or use of proceeds in line with such targets, by an independent expert at agreed points during the life of the bond. The FCA should require

[51] Corke et al., *Green Bonds Series: Part 4 - When 'Green' Bonds go Brown*, Lexology October 17, 2019
[52] International Financial Law Review, *Critical challenges facing the green bond market*, October/November 2019, p.23-24, including *Figure 4 Mexico Airports: the green bond that wasn't*
[53] IIGCC Net Zero Bondholder Stewardship Guidance p. 17; and Net Zero Investment Framework p. 18
[54] Corke et al., *Green Bonds Series: Part 4 - When 'Green' Bonds go Brown*, Lexology October 17, 2019; and Curtis et al., 2023, *Green Bonds, Empty Promises*
[55] ClientEarth, *Response to FCA CP 22/20*, January 2023

that such disclosures are not undermined by disclaimers, limiting language or structural loopholes like late dated KPIs or call options[56] which detract from the value of the disclosures.

To discuss the contents of this submission further, please contact:

Robert Clarke
Lawyer
rclarke@clientearth.org
www.clientearth.org

Catriona Glascott
Lawyer
cglascott@clientearth.org
www.clientearth.org

Beijing Berlin Brussels London Los Angeles Luxembourg Madrid Warsaw

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[56] The World Bank IFC, *Structural Loopholes in Sustainability-Linked Bonds*, 19 May 2022