Department for Business, Energy & Industrial Strategy

Consultation on requiring mandatory climate-related financial disclosures by publicly quoted companies, large private companies and Limited Liability Partnerships (LLPs).

RESPONSE FROM:

United Kingdom Shareholders' Association

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To: Department for Business, Energy & Industrial Strategy

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1. Introduction

1. Climate change is an important issue for the UK and the rest of the world. We therefore strongly support any initiative which improves climate change reporting by UK companies, and which results in better information being provided to shareholders so that they are better informed and better able to hold companies to account.

2. We understand the government's reasons for wishing to introduce mandatory climate-related financial disclosures by publicly quoted companies, large private companies and LLPs. In principle this makes good sense in helping to focus attention on climate change and its impact on business and investors. It should also bring all publicly quoted and large private companies into line with their climate-reporting.

3. We support the Government's proposal to use the TCFD's four-pillar framework of Governance, Strategy, Risk Management and Metrics and Targets as the basis of the disclosure requirements, adjusted as necessary to make requirements coherent with UK company law.

4. We are also support the principle that high-quality disclosure on how organisations will manage the material financial risks and opportunities arising from climate change should improve transparency and encourage more informed pricing and capital allocation.

5. Unfortunately, we are very concerned that what we are being presented with in the consultation paper falls well short of being a blueprint for high-quality disclosure in climate-change reporting. Specific concerns that we have are:

    5.1. The current lack of a standard taxonomy for climate-related reporting, including standard metrics and measurement systems. Former governor of the Bank of England and now UN climate advisor, Mark Carney, has already inadvertently thrown a spotlight on climate claims and the contested definition of 'net zero', as recently reported by the Financial Times.[1] Mr Carney claimed at a Bloomberg conference that Brookfield was net zero across its entire $600bn portfolio because of the "enormous renewables business that we've built up and the avoided emissions that come with this." Climate experts deemed this 'greenwashing', pointing out that avoided emissions do not count towards the achievement of net zero goals. As the Financial Times

[1] Financial Times 9.4.21: Carney's stumble at Brookfield puts focus on loose definition of net zero.

says “the backlash illustrates the complexity of climate reporting, which lacks standardisation and is open to manipulation, and the ease with which even experienced climate ambassadors can fall foul of the still emerging rules.” Our view is that until a basic standard taxonomy is agreed and put in place there is little point in mandating a wide range of companies to make climate related disclosures. Much of the information provide is likely to be suspect and the reporting will be discredited.

5.2. The suggestion that the additional climate related disclosures should go into the strategic report within the annual report requires further careful consideration. The annual report has already had more than enough additional material shoehorned into it over recent years with much of it becoming little more than compliance boilerplate. There is a real likelihood that the additional reporting proposed in the consultation paper will simply add to this. The current BEIS consultation on ‘Rebuilding Trust in Audit and Corporate Governance’ specifically raises questions about the future structure of the annual report and about the possibility of providing greater audit oversight and assurance of content such as that relating to climate change disclosures – in particular the achievement of targets. The FRC’s discussion paper on the structure of the annual report, ‘A Matter of Principles’, raises the possibility that climate change reporting might be better separated from the annual report and presented as a free-standing report with appropriate cross-references to the annual report. These are important issues that merit serious discussion before being taken forwards. Regardless of this the Government seems intent on ploughing ahead with potentially flawed proposals which will pre-empt initiatives to ensure that climate change reporting is presented to investors in the most effective and useful way.

5.3. There is no clear implementation plan in the consultation document for the introduction of the proposed mandatory reporting to ensure that it delivers on its main purpose – namely that of ensuring that ‘*all UK companies and LLPs above certain thresholds give due consideration to climate change in risk assessment and decision making while providing a good level of disclosure to financial markets*’. Instead, there are vague claims that the Government “will be launching a UK Green Technical Advisory Group in 2021”, a claim that the “Government is committed to supporting stakeholders in their ability to access data and has invested £10m to launch the UK Centre for Greening Finance and Investment (CGFI)” assuring us that “the Oxford University led centre will provide world-class data and analytics to financial institutions.”

There is also reference to the ‘International Financial Reporting Standards (IFRS) Foundation’s proposal to create a new, global Sustainability Standards Board’. We have been party to discussions about this and we support it, but its creation is still some way off and meaningful outputs are likely to be several years away.

5.4. Despite the lack of a coherent plan for introducing mandatory climate disclosures in a helpful and meaningful way, and a lack of clear guidance for producers of reports, the government is proposing a Common Commencement Date of 6th April 2022, and that the new requirements be applicable for accounting periods starting on or after that date. We think that this is too soon and is impractical. It will compromise the chances of investors receiving reliable and meaningful information with which to hold companies to account.

6. We note the relatively short response time for this consultation. It is difficult to avoid the conclusion that, rather than aiming to promote better and more comprehensive climate reporting, this initiative is an eye-catching political stunt to burnish the UK Government’s green credentials ahead of the G7 Summit and CoP 26 meeting later this year. We strongly support the principle of better climate-change reporting by UK companies and agree that it should be mandatory. Unfortunately, we can’t support a number of key proposals being put forward in the in the consultation document in their current form.

7. Our answers to each of the seventeen questions in the consultation paper are shown in Section 3 below.

2. About UKSA

8. **UKSA (UK Shareholders' Association)** is the oldest shareholder campaigning organisation in the UK. We are a not-for-profit company that represents and supports shareholders who invest in the stock market.

9. There are many agents and intermediaries active in financial markets. Unlike them, we are an organisation solely representing people who are investing their own money.

10. UKSA was formed to provide private shareholders with a voice, influence and an opportunity to meet like-minded fellow investors. It is structured as a non-profit making company with annual subscriptions. An elected Chairman and Board of Directors (all volunteers and individuals with a wide range of backgrounds and experience) monitor a regional organisation. Each region benefits from oversight by an elected regional Chairman and Committee.

11. We build relations with regulators, politicians and the media to ensure that the voice of individual shareholders is reflected in the development of law, regulation, and other forms of public policy.

3. Answers to your numbered questions

QUESTION 1: Do you agree with our proposed scope for companies and LLPs?

12. Yes

QUESTION 2: Our proposed scope includes UK registered companies with securities admitted to AIM with more than 500 employees. Do you have any views on expanding this to include other unregulated markets and Multilateral Trading Facilities (MTFs)?

13. No

QUESTION 3: Do you agree with the proposal to require climate related financial disclosures for companies and LLPs at the group level?

14. Yes

QUESTION 4: Do you agree that the Strategic Report is the best place for the disclosure of climate-related financial information by companies?

15. No, not necessarily. We think that this is a doubtful idea for the following reasons:

    15.1. The annual report is already busting at the seams with content that has been shoe-horned in over many years with little thought being given to overall usefulness and usability of much of the information to those who are supposed to benefit from it.

    15.2. Much of this ‘supplementary’ information has been subverted to become nothing more than compliance boilerplate. There is real risk that mandatory climate-change reporting could go the same way.

    15.3. The FRC is working on a major review of annual reporting and is considering how the current content contained in the annual report can best be presented so that it is meaningful, relevant and useful to investors and other stakeholders. BEIS’s deliberations on where and how best to present climate change information need to be part of this review.

15.4. Our own thoughts at this stage are that it might be better if companies were to produce a separate ‘climate report’ which would cover all reporting (mandatory and voluntary) on climate reporting. This would give climate change reporting greater focus. . Were appropriate, content should be cross-referenced between the annual report and the climate report.

15.5. If this initiative is worth doing, it is worth doing right. There should be clear guidance given on scope and content of the climate report. There will also be a need to ensure that metrics are, if not standardised, then at least comparable across companies and business sectors. Comparability over time will also be required. Similarly, clear guidance will need to be given on the drafting of the content so that it does not descend into an annual ritual of boilerplate, greenwash, marketing and general burnishing of companies’ environmental credentials.

15.6. It will also be important that companies use materiality or proportionality to decide what is important to readers and what is not. Producers of reports should not be able to hide behind boilerplate compliance-statements.

15.7. The content should be quality-reviewed for all the above. The FRC should be consulted on how this can best be achieved.

QUESTION 5: Do you have views on whether LLPs should be required to disclose climate-related financial information in the Strategic Report (where applicable), or the Energy and Carbon Report?

16. We have no views on this. However, note our comments above that this initiative justifies requiring companies to produce a separate ‘climate report’. This would deal with the different reporting requirements that currently exist for LLPs and listed companies.

QUESTION 6: Do you agree that requiring disclosure in line with the four pillars of the TCFD recommendations, rather than at the 11 recommendation level is suitable?

17. Yes, for the time being. This can be reviewed and amended if companies are failing to provide sufficient granularity of information. However, if appropriate guidance is given to preparers and a regime of quality-reviews is introduced, as outlined in our response to Q4 above, this should not be a problem.

QUESTION 7: Do you agree that information provided in line with the obligations set out above would provide investors, regulators and other stakeholders with sufficient information to assess the climate-related risks and opportunities facing a company or financial institution?

18. We are not able to comment authoritatively on this. However, we note that:

    18.1. The governance requirements set out in the consultation document look as though they will result in the provision of process-related information with little or no requirement for companies to report on the effectiveness of the governance arrangements and whether they are achieving the desired outcomes.

    18.2. Much business model reporting is very poor. It is often generic (it could apply to almost any business) and gives little indication of how a company actually creates sustainable value. It therefore provides a weak basis for articulating how the company’s business model and strategy may change in response to effects relating to climate change, and the trends and factors that affect this change.

    18.3. Much risk reporting is also currently poor. As above, so-called ‘risks’ identified are often a list of relatively generic uncertainties with little attempt to explain how the have been prioritised or to describe the specific actions taken by management to mitigate them. Far too many companies talk vaguely about ‘geo-political’ risks but make no attempt to articulate what these are in the context of their own businesses. If they are concerned about China provoking a war over Taiwan then they should say so and say why it is particularly important to the business.

19. It is striking that while many businesses talked in their 2019 annual report about significant risks that might affect their markets, none (as far as we are aware) mentioned the possibility of a global pandemic. This was despite many warnings that the world was due for a potentially damaging pandemic.

20. The same requirement for specific analysis should apply to climate risks. Much climate reporting is vague and unhelpful. Risk reporting in general needs ‘sharpening’ before encouraging companies to add more compliance boilerplate into the annual report. Implementation of recommendations in the current BEIS consultation on improving trust in audit and corporate governance have an important role to play in this respect.

21. This does not bode well for the production by companies and LLPs of meaningful information on climate related disclosures. More work in this area is

required to ensure that the new rules will result in meaningful and useful disclosure for stakeholders.

QUESTION 8: Do you agree with our proposal that scenario analysis will not be required within a company or LLP's annual report and accounts?

22. Yes, but if a decision is made to have a separate climate report (rather than putting all climate-change reporting into the annual report) then this should be reconsidered. Scenario analysis would be a valuable component of a dedicated climate report and might help to address the issues of materiality and proportionality raised in our answer to Question 4.

23. The FRC's proposals on the future of corporate reporting ('A Matter of Principles' - October 2020) make a clear case for a separate climate-change report with hyperlinks to the annual report. If the government is serious about climate change reporting this would be a much better way of dealing with the issue rather than simply dismissing the potential use of scenario analysis.

QUESTION 9: Would alignment of the scope for climate-related financial disclosures and SECR requirements, such that large unquoted companies and LLPs would be subject to the same reporting requirements under SECR as quoted companies, aid reporting of climate related financial disclosures and simplify reporting procedures? Do you have any views on the continuation of voluntary Scope 3 emissions reporting under SECR requirements?

24. We have no desire to see business being forced to shoulder undue administrative burdens. However, there can be no point whatsoever in asking business to spend time producing information that is incomplete with material gaps in energy use and emissions reporting and which is therefore potentially misleading. We believe that there has to be alignment at least for Scope 1 and 2 requirements.

25. Reporting meaningfully on Scope 3 requirements is likely to be more complex. For the time being we believe that this should remain voluntary. However, it is an important issue; it should not be possible for a business to 'game' the system by 'off-shoring' polluting activities and avoid reporting on them while other companies operating the same processes in the UK have to report on them. Plans should be put in place for the introduction of mandatory reporting on Scope 3 emissions by 2026.

QUESTION 10: Do you have comments on the proposal to permit non-disclosure if the information is not material and the reasons why climate change is not material are properly explained?

26. This proposal appears reasonable and sensible. Indiscriminate reporting is not helpful, wastes time and often obscures the issues that really matter.

QUESTION 11: Do you have comments on the proposed timing for these regulations coming in to force?

27. As outlined in our response to Q4 above, we think that it might be better if companies were required to produce a specific climate change report and that this should be part of the FRC's current wider review of corporate reporting. In view of this, we think trying to bring new rules into force by 6th April 2022 is too soon. For the sake of, say, another twelve months it would be worth spending more time to ensure that the introduction of new climate-reporting disclosures are sound and effective in helping investors and other stakeholders to hold companies to account.

28. We are concerned that the proposed timeline appears, in part, to owe more to a desire by the UK government and its politicians to rush-out a half-baked initiative with the aim of making them look good in the context of the UK's G7 and CoP26 Presidencies later this year, rather than by a desire to promote meaningful climate-change reporting by UK companies.

QUESTION 12: Do you have any comments regarding the existing enforcement provisions and the BEIS proposal not to impose further provisions?

29. We have no comment to make on this.

QUESTION 13: Do you have any comments regarding duties and enforcements for LLPs?

30. We have no comment to make on this.

QUESTION 14: Do you have any comments on the responsibilities of auditors in relation to climate-related financial disclosures?

31. We believe that some sort of third-party assurance of climate change reporting is likely to be important. However, much more work is required to agree exactly what is needed and whether the company's auditors or another (perhaps specialist) agency should do this. We agree that this should be considered in the Government's current programme of corporate governance and audit reform.

32. This further reinforces our belief that the proposed introduction date of 6th April 2022 for the new rules premature and impractical in the context of wider reforms being considered for the reform of corporate reporting.

QUESTION 15: Do you have any comments regarding the proposed enforcement of our disclosure requirements?

33. We have no comment to make on this.

QUESTION 16: Do you have any comments regarding the impact of our proposals on protected groups and/or how any negative effects may be mitigated?

34. We have no comment to make on this.

QUESTION 17: Do you have any further comments about our proposals?

35. We have no further comments on the proposals.