CONSULTATION RESPONSE

FINANCIAL REPORTING COUNCIL: FUTURE OF CORPORATE REPORTING

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An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

THE PRINCIPLES FOR RESPONSIBLE INVESTMENT

The United Nations-supported Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has over 3,000 signatories (pension funds, insurers, investment managers and service providers) globally with approximately US $100 trillion in assets under management.[1]

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society. The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

This consultation response represents the view of the PRI Association and not necessarily the views of its individual members. More information: www.unpri.org

ABOUT THIS CONSULTATION

Under this proposal, the FRC aims to strengthen company accountability to a diverse array of stakeholders, and mandate non-financial reporting to stand alongside statutory financial reporting. The proposal would unbundle the annual report by splitting mandatory reporting across three reports – the financial statements, the Business Report, and the Public Interest Report – each of which has a different end-user audience, a different objective, and a different threshold for materiality per that objective. The proposed reporting network would be supported by underlying principles at the content level, report level, and system level, and would account for firms of varying sizes, with the largest firms (Public Interest Entities) being required to publish all three reports.

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[1] See https://www.unpri.org/signatories/signatory-resources/signatory-directory

SUMMARY OF THE PRI'S POSITION

The PRI welcomes the opportunity to respond to the FRC's proposal for the future of corporate reporting. The PRI encourages continued conversation that supports corporate accountability to a wide range of stakeholders and elevates sustainability reporting to the same level of importance as financial reporting.

The PRI supports the FRC's proposal to introduce statutory sustainability reporting on how ESG issues impact a company's financial performance or value, and how a company's activities impact stakeholders and the environment as part of the reporting framework.

There is significant alignment between the financial interests of long-term shareholders and the needs and interests of a wider range of stakeholders impacted by a company's activities. Issues such as human rights harm, environmental pollution and climate change have relevance both in terms of the financial interests of shareholders and the expectations and rights of other stakeholders. In addition to understanding potential financial risks and opportunities, a focus on social, environmental, as well as economic/financial performance allows both companies and their underlying investors to:

- Identify opportunities, such as through changes to business models, across supply chains and through new and expanded products and services.
- Prepare for and respond to legal and regulatory developments, including those that may lead to asset stranding.
- Protect their reputation and licence-to-operate particularly in the event of negative outcomes from operations.
- Meet institutional commitments to global goals such as the Sustainable Development Goals (SDGs), and communicate on progress towards meeting those objectives.
- Minimise negative impacts and increase the positive impacts of products, services and operations.

The PRI recommends that the FRC:

- Does not separate information on companies' ESG risks and opportunities from information on sustainability performance, to ensure that sustainability information is reported in a coherent and consistent manner and aligned with companies' long-term sustainability goals.
- Ensures corporate reporting remains relevant for investors as a primary audience.
- Revises the reporting principles to apply to the system-level and content-level, positioning the UK corporate reporting system as one in which reports can easily be compared across industries and across markets.
- Ensures reporting requirements on non-financial information is aligned with and based on international standards as they develop, that are already understood and well used by companies and investors.

DETAILED RESPONSE

Q1. What are your views on our proposals as a whole? Are there elements that you prefer over others?

The PRI supports the proposal to place sustainability reporting on a similar statutory basis as financial reporting by requiring Public Interest Entities to publish annual sustainability reporting, covering both how ESG issues impact a company's financial performance or value and how a company's activities impact stakeholders, the environment and society as a whole. Furthermore, we welcome most of the proposed principles underpinning the reporting framework (see question 4) and statement on how a company views its obligations in respect of the public interest (see question 8).

The PRI cautions against separating out sustainability information intended for different end-users in multiple reports and communications.

For investors, a variety of information is needed to make evaluations for their investment and stewardship strategies. This is best served by consistent and coherent corporate sustainability reporting, which does not separate information on ESG risks and opportunities from information on a company's sustainability performance, and which is aligned with financial reporting. Sustainability impacts that companies have on the environment, people or society may also have impact on financial value, and the dynamic between sustainability impacts and financial materiality can change with time. Therefore, end users of reports need to easily access a range of information to determine the materiality of an ESG issue relative to financial considerations and its substance relative to social goals or planetary threshold, for example the Paris Agreement.

Q2. What do you see as the key practical challenges of implementing our proposals? Do you have any suggestions as to how these could be overcome? What do you see as the costs and benefits of the new model?

Creating a network of multiple reports with different audiences and different materiality assessments may limit the ability of companies to present an overarching vision and strategy and risks pre-determining which is deemed relevant for end users.

More specifically, spreading 'non-financial' reporting across two separate reports (the Business Report and Public Interest Report) risks signalling that investors may not need to consider companies' impacts in their approach to investment and stewardship. This approach would deviate from current market developments, which are shifting to focus on the alignment or contribution – both positive and negative – of corporate and investor activity in meeting sustainability goals. In addition, spreading information on ESG risks and opportunities and sustainability performance across two separate reports also increases the risk of inconsistent sustainability information.

Q4. Do you consider the set of principles (system level attributes, report level attributes and content communication principles) in section 2 would be helpful in improving the quality of corporate reporting today and in the future?

The proposed attributes and principles provide a helpful framework for corporate reporting, regardless of the form that corporate reporting should take. As we do not support the proposed reporting network, PRI recommends integrating the report-level attributes of ‘fair, balanced and understandable’ and ‘true and fair’ into the remit of the system-level attributes and content communication principles.

Q5. Do you agree with our proposals to improve the relevance and accessibility of information, involving more concise reports distributed across a reporting network?

The PRI disagrees with the proposal to publish more concise reports distributed across a reporting network. Publishing information on a company’s ESG risks and opportunities and information on a company’s sustainability performance across two separate reports does not serve investor needs and risks signalling that information on a company’s sustainability performance is not material for investors. In addition, the proposal hampers the ability for a company to present an overarching vision and strategy and could lead to inconsistent sustainability information.

Q6. We are proposing that there should no longer be a single test for materiality that is based on accounting standards but instead materiality will be dependent on the objective of a report. Do you agree with this approach?

The PRI strongly supports adopting a wider materiality test for corporate reporting that extends to reporting on ESG factors likely to impact the financial or operating performance of a company and how a company’s operations and products impact (positively or negatively) stakeholders, the environment and society.

However, we do not agree with making the materiality test dependent on the objective of the report. Separate materiality tests threaten the consistency of information reported in a time when data reliability, comparability and quality remain among the biggest challenges for investors. By splitting out reporting metrics for different audiences, there is a risk of investors missing out on key information needed for decision-making, particularly regarding sustainability reporting.

Q7. Do you believe that there is a need for regulatory standards for non-financial reporting? If so, what do you consider the scope of the information that should be covered by these standards?

Yes, the PRI agrees that there is a clear need for mandatory, harmonised sustainability reporting standards in order to support investment decision-making that prioritises and incentivises sustainable investment and outcomes. Corporate sustainability reporting is critical to the ability of investors to take into consideration material ESG risks and opportunities, and increasingly important to understand corporate and investor activity in meeting sustainability goals. However, investors state that the consistency, comparability, and quality of corporate reporting is a substantial barrier to their investment practice.

The PRI encourages efforts by public and private initiatives toward alignment and consolidation of sustainability reporting. However, as acknowledged by the FRC in its paper, these efforts are most effective when undertaken on a global level and the recent proposal by the International Financial Reporting Standards (IFRS) Foundation to create a Sustainability Standards Board (SSB) and joint commitment by CDP, CDSB, GRI, IIRC and SASB to support the IFRS proposal are developments worth noting in this context.

In developing its own non-financial reporting standards, we recommend that the FRC works closely with other regulatory bodies and initiatives on sustainability reporting and adopt those that are already understood and well used by companies and investors. Principal among these are:

- The recommendations from the Taskforce on Climate-Related Financial Disclosures (TCFD);
- The International Organization of Securities Commissions (IOSCO)'s efforts to determine which non-financial information is decision-useful for the investors, and its ambitions to use that information to develop a framework for principles-based guidance for future standard setters.
- The work of the European Commission and EFRAG on establishing an EU non-financial reporting standard.

Regarding the scope of the information that should be covered by potential regulatory standards for non-financial reporting, we believe corporate sustainability reporting should:

1. Provide current and forward-looking information to assess the full range of sustainability risks and opportunities.
2. Enable investors and other stakeholders to consistently assess and compare a company's sustainability performance and alignment in the context of long-term sustainability goals and thresholds.
3. Recognise the relevance of global and local sustainability objectives in contextualising and tracking a company's sustainability performance.

Q8. Do you agree with the need for companies to provide information about how they view their obligations in respect of the public interest?

PRI supports the inclusion of a statement on how companies view their obligations in respect of the public interest. A statement of this kind would be a welcome complement to a company's stated purpose and vision to help to strengthen accountability of a company to its varied audience of stakeholders.

Q12. What other areas do you see being necessary or relevant to the development of a model for corporate reporting that is fit for the future?

As reporting evolves to include more mature assessments of sustainability, third-party assurance is going to have to evolve alongside this to verify these standards and maintain trust in the reporting system.

The FCA noted in its recent policy statement PS 20/17[2], that as premium-listed issuers are required to disclose TCFD alignment, third-party assurance will be necessary and should be developed over the long-term. PRI supports this approach. The FCA also committed to working with the FRC and HM Government to issue guidance on third-party assurance of TCFD-aligned disclosures. The PRI welcomes communication from the FRC on its plans for working with the FCA and HM Government.

[2] https://www.fca.org.uk/publication/policy/ps20-17.pdf