CORE PUTTING PEOPLE & THE PLANET AT THE CORE OF BUSINESS

Mark Jackson,

Business Environment,

Department for Business, Innovation and Skills

Via email to mark.jackson@bis.gsi.gov.uk

15 April 2016

Dear Mark,

Response to 'The Non-Financial Reporting Directive: A call for views on effective reporting alongside proposals to implement EU requirements'

CORE is the UK civil society coalition on corporate accountability. We work with our partner organisations to advance the protection of human rights and the environment with regard to the global operations of UK companies, by promoting a stronger regulatory framework, higher standards of conduct, compliance with the law, and improved access to remedy for those harmed by the activities of UK companies.

CORE welcomes the opportunity to share our views on the transposition of the Directive.

Our full response to the consultation is enclosed and we are happy for it to be published.

Yours sincerely,

Marilyn Croser

Director

Introduction

The EU Non-Financial Reporting (NFR) Directive (the Directive) is a notable step forward for corporate transparency in Europe. Much of the content of the Directive builds on existing requirements in UK law and if implemented appropriately will help to level the playing field for UK companies already reporting on these issues.

As noted in the preamble to the Directive, proper disclosure including environmental, social and governance (ESG) information is 'vital for managing change towards a sustainable global economy by combining long-term profitability with social justice and environmental protection.'[1]

Disclosure of this information assists with measuring, monitoring and managing of a company's performance and impact on society and can be used to incentivise company behaviour through a variety of financial, governance, operational and stakeholder levers.

Disclosure is a crucial component in mobilising the power of capital markets - by encouraging investors to play an active stewardship role - to bring about changes towards a sustainable global economy. Promoting good governance and stewardship has been noted as a central function of equity markets. The flow of actionable information to shareholders is crucial to promoting efficient capital allocation which supports the government's ambitions for the economy around productivity, growth and decarbonisation.

Q1: Flexibility on where to provide the non-financial statement

In the interests of clear, concise and relevant reporting, and keeping up with best corporate practice in relation to due diligence and reporting, we recommend that the information required by the Directive remains in the Strategic Report.

Materiality of ESG information

Much of the information required to be reported under the Directive is related to ESG matters, however, it is not always helpful to assume that ESG information is non-financial information. This delineation can be inaccurate because certain ESG information (required to be disclosed by the Directive) can be financially material for companies.

ESG information can be integral to a full understanding of a company's position and likely future performance and often affects a company's licence to operate, customer reputation, sustainability, governance and management, all of which can translate directly into serious adverse financial consequences in terms of investability, creditworthiness etc. Conversely, emerging evidence shows that companies which perform well on ESG issues tend to produce better returns for investors, particularly over the long term.[2]

[1] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups Text with EEA relevance (available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0095)

[2] Arabesque Partners and University of Oxford (2015), 'From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance' (available at http://www.arabesque.com/index.php?tt_down=51e2de00a30f88872897824d3e211b11), assesses over 200

This is already recognised to some extent by the existing UK regime related to the Strategic Report. The legislative provisions in the Companies Act 2006 reflect that certain ESG information is necessary for an understanding of the development, performance and position of the company's business and the Financial Reporting Council's (FRC) guidance on the Strategic Report emphasises there can be a strong relationship between these matters and the development, performance and future prospects of the company.[3]

Indeed the very purpose of the Strategic Report is to inform shareholders and help them assess how the directors have performed their duty under S172 of the Companies Act 2006, to promote the success of the company and have regard to (among other things) the impact of the company's operations on the community and the environment.

Informing shareholders and investors

The Consultation states that the government wants 'to ensure that shareholders and investors have sufficient information to be active stewards of the companies they own'.[4] In order to play an active stewardship role, it is crucial that investors have access to sufficient, accurate, timely and relevant information about the companies in which they invest. Allowing the information required by the Directive to be reported separately risks failing to provide investors with actionable information which they can incorporate in their investment decisions.

Evaluation of the risks and opportunities associated with non-financial information is playing an increasingly central role in investors' selection, retention and stewardship of their investments. If information on company activity relating to environmental, social, employee and other relevant matters is disclosed separately from the Strategic Report, this creates an additional layer of complexity for investors.

Encouraging integrated reporting

Over the last five years, reforms to the UK's narrative reporting regime aimed to promote integration between financial and non-financial information, exemplified by the addition of a requirement to report on company business model in the Strategic Report and reflected in the FRC's guidance. If it became permissible to publish the non-financial information separately, the benefit of encouraging companies to consider the linkages between ESG factors and financial performance would be lost. Allowing separate financial/non-financial reports now might make it more difficult to

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of the highest quality academic studies to provide a broad perspective on the economic evidence for sustainability. The results suggest that 90% of studies on the cost of capital reveal that sound sustainability practices lower the cost of capital for firms and 88% of the research suggests that solid ESG practices lead to better operational performance of companies. Similarly, 80% of studies show that stock price performance is positively influenced by good sustainability practices. The report argues that strategies incorporating ESG issues outperform similar non-ESG strategies.

[3] FRC (Financial Reporting Council) Guidance on Strategic Reporting, June 2014 (available at https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Guidance-on-the-Strategic-Report.pdf)

[4] The Non-Financial Reporting Directive: A call for views on effective reporting alongside proposals to implement EU requirements, February 2016 (available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/500760/BIS-16-35-non-financial-reporting-directive-consultation-February-2016.pdf)

adapt to any future developments in reporting which continue the trend toward increased integration.

A separate non-financial report will militate against integration of ESG considerations into the company's overall risk assessment and analysis processes. Given the different purposes and audiences for corporate social responsibility (CSR) reports, material which is relevant to understanding how well directors are meeting their duty to promote the success of the company over the longer term is likely to be mixed with more general information. This seems contrary to the government's policy objective of making reporting more concise, streamlined, relevant and useful to shareholders. Government should be encouraging greater integration of social, environmental and human rights due diligence into corporate decision-making, rather than fostering a separate reports approach, which tends to reinforce the idea, now rejected by many businesses that CSR is an optional extra. It is unclear how publishing a separate report will simplify reporting obligations for companies, who would have to determine what is or is not properly financial, or users of that information, who would have to read a separate report. It would seem simpler to maintain a single report.

Q2: Information that could be placed in a Separate Report

See responses to Q1 and Q3.

Q3: Advantages and Disadvantages of a separate non-financial statement

The principle potential disadvantage is that key information becomes harder to find because it is diffused throughout several separate reports, which are not published simultaneously and are located in different sections or pages of the company website. There can be a tendency to include superfluous, marketing-type information in these publications, blurring the focus on key impacts and risks. There is also a risk that information published outside of the Annual Report, particularly if not published at the same time as the Annual Report could be subject to less scrutiny from shareholders and other stakeholders.

Q4: Advantages and disadvantages of the various implementation options

Option 1: Update the existing reporting framework to reflect the new requirements

Option 2: Reduce the scope of the existing UK requirements and limit it to those required to report under the directive.

The Directive is intended to improve corporate disclosure of social and environmental information, with a view to enabling the identification of risks and increasing investor and consumer trust. Without this disclosure, the various levers to incentivise company behaviour cannot be utilised. If investors do not have all relevant information to hand, they will not be able to factor this information into their investment decisions.

The proposal in Option 2 to remove existing reporting requirements for listed companies is unacceptable, as it fails to reflect the Directive's purpose and would severely undermine the UK's reputation for high standards of corporate governance. In its recent report, 'Clear & Concise: Developments in Narrative Reporting', the FRC found that the quality of reporting in this area has generally improved in recent years.[5] In light of this, and the growing demands from shareholders and other stakeholders for greater transparency, it would be counter-intuitive to seek to reduce the scope of existing UK reporting requirements.

The Investment Association's recently published Productivity Action Plan states that investors want to 'see improvements in reporting on the long-term drivers of sustainable value creation', particularly highlighting the need for companies to report on how their human capital management has impacted their productivity and long-term prospects.[6] The importance of environmental considerations for institutional investors was recently highlighted when the 2015 diesel emissions scandal resulted in a coalition of 19 investors with over £625 billion in assets under management writing to 11 major automobile companies to call for improved reporting of their public policy interventions on emissions standards.[7] Relaxing the requirements on company reporting will shift the burden of information-seeking onto investors, and ultimately onto the individual saver. The resulting inefficiencies will increase overall costs to the economy.

Option 1 is better, however, we agree that this could create unnecessary complexity. The reporting regime underwent significant reform only a few years ago and the reporting requirements in Directive do not represent a dramatic departure from the existing requirements in the Companies Act 2006. Our view is that creating separate reporting requirements for large PIEs would not be helpful for companies (many of which have invested in creating systems to facilitate reporting) and stakeholders, and would create a two-tier reporting regime based purely on company size. Companies which benefit from being able to raise capital by listing should be subject to the same requirements, regardless of the numbers of people they employ.

Q5: Preferred option relating to scope

Our preferred option is set out in response to Q6 below. Of the two options proposed in the consultation document, our preference is Option 1.

Q6: Are there any other options for implementing the EU NFR directive that the government should consider?

Yes. The government should consider updating the existing reporting framework to reflect the Directive, and extending its scope so that it applies to all listed companies and to the largest non-listed companies as well. Our understanding is that there is scope under the Directive for the UK government to designate these companies as PIEs since they are of significant public relevance due to the nature of their business, their size and/or their of employees.

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[5] FRC Clear & Concise Developments in Narrative Reporting, December 2015 (available at https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Clear-Concise-Developments-in-Narrative-Reporti.aspx)

[6] The Investment Association: Supporting UK Productivity with Long-Term investment, March 2016 (available at Investment Association's recently published Productivity Action Plan)

[7] Share Action: Concerned investors with over £625 billion under management call for greater clarity on emissions lobbying by automobile companies, October 2015 (available at https://shareaction.org/press-release/concerned-investors-with-over-625-billion-under-management-call-for-greater-clarity-on-emissions-lobbying-by-automobile-companies/)

A typical top UK private company has sales ranging between £700 million and £3 billion and employs between 500 and 20,000 staff.[8] Significantly-sized UK private companies are operating in sectors that are recognised as having a heightened risk of adverse human rights impacts, including construction, garments, international transport, and food. Requiring these companies to report would provide valuable information to stakeholders on how potential risks and impacts are being managed.

Q7 - 9: Should government require the non-financial statement be verified by an independent assurance service provider? Advantages and disadvantages of requesting third party assurance? Are there any other options the government should consider for third party verification?

No response.

Q10: Advantages / disadvantages of preparing / receiving NFR statement electronically via a company's website.

Non-financial information should remain within the Strategic Report, regardless of whether this is provided in printed form or electronically. Printed copies of Annual Reports tend to be distributed to shareholders only, with other stakeholders accessing reports via the company's website. We would recommend therefore that government facilitate ease of access to Annual Reports online by replicating the provision in section 54 of the Modern Slavery Act which requires companies to link to their slavery and human trafficking statement from a prominent place on their website's homepage.[9] We would also recommend that the government considers creating a single website to which Annual Reports could be uploaded, to further enable comparisons of company performance on ESG issues.

Q11 – 14: No response

Q15: What other reporting regulations would you suggest that could be repealed?

We do not support the proposal to remove the requirement to report on policy on employment of disabled persons. The current disclosure requirement is very detailed (requiring a statement of the company's policies in relation to: giving full and fair consideration to applications for employment made by disabled persons; continuing the employment of, and for arranging training for, employees who have become disabled when they were employed by the company; and the training, career development and promotion of disabled persons employed by the company.) The new requirement under the Directive is simply that the corporate governance statement must contain a description of the diversity policy applied in relation to the company's administrative, management and supervisory bodies with regard to, for instance, age, gender, educational and professional background and setting out the objectives of the policy, its implementation and the results obtained. Although the requirement to report on results is welcome, disability is not mentioned even by way of example. Also, the existing requirement applies to any company with an average of 250+ employees, whereas (depending on the option for transposition chosen) the NFR directive may apply only to companies with 500+ employees.

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[8] See the *Sunday Times* 'Fast Track 100: Britain's private companies with the largest sales' http://www.fasttrack.co.uk/league-tables/top-track-100/

[9] Section 54 (7) of the Modern Slavery Act 2015, http://www.legislation.gov.uk/ukpga/2015/30/section/54/enacted

Q16: Is there any information that could be moved outside the Annual Report?

No response

Q17-18(f): No response

Q18(g): Any other comments about the costs and benefits that will result from the EU NFR directive?

While some companies will undeniably incur costs as a result of having to comply with the new requirements, these are significantly outweighed by the potential for the wider benefits outlined in this response, including in relation to risk management. A minimalist approach to implementing the Directive could jeopardise this.

Q19: Any other comments

The BIS workshop organised as part of the consultation was a helpful opportunity to discuss the government's thinking around the transposition of the Directive. We would recommend that, time permitting a multi-stakeholder session is organised to discuss the government's response and the proposals for transposition. A similar session held during the process to amend the Companies Act in 2012 was a useful chance to exchange ideas and hear a range of views on corporate reporting.

ENDS