UK FINANCE

Smarter regulation non-financial reporting review

UK Finance response to DBT call for evidence

16 August 2023

Introduction

UK Finance is the collective voice for the financial services industry. Representing around 300 firms, we act to enhance competitiveness, support customers, and facilitate innovation. We welcome the opportunity to comment on the call for evidence (CfE) "Smarter regulation non-financial reporting review", issued by the Department for Business and Trade (DBT).

We welcome DBT's recent announcement of its intention to introduce UK Sustainability Disclosure Standards, based on standards issued by the International Sustainability Standards Board (ISSB). We believe the UK's standards should align with the ISSB's without carve-out in content, and that disclosure against them should be required for a wide range of firms, with proportionality considerations as relevant for smaller firms. Our response sets out the benefits and cost savings we expect would result from such an approach, to aid DBT's technical work to inform a decision on formal endorsement of the ISSB standards. We also provide some high-level comments on non-financial reporting.

DBT's non-financial reporting proposals

UK Finance supports non-financial reporting requirements that provide investors with decision-useful information on the risks and opportunities associated with non-financial issues including sustainability matters. As users and preparers of non-financial reporting, financial services firms have a unique interest in getting the non-financial reporting regime right.

UK Finance and our members have identified the following challenges with the current non-financial reporting regime:

- The current reporting landscape is **fragmented and complex**, comprising a variety of sources (e.g. listing rules, various codes, accounting regulations) and thresholds. UK law is often out of date, requiring users to include disclosures that are largely obsolete in annual reports. This wide array of expectations risks drowning out the core requirements that should be the focus of decision-useful reporting for investors.
- Non-financial reporting is **less mature** than financial reporting: investors and users are expecting a fast-tracked evolution of reporting to levels that have taken decades to be achieved in financial reporting. It is therefore not currently possible to expect the same standards of assurance as are achievable for financial reporting.
- The non-financial reporting regime **struggles to keep pace with investor needs**. The most important non-financial reporting requirements are, by necessity, frequently changing: static requirements therefore quickly become outdated.
- These reporting requirements can become burdensome for all companies, particularly **smaller companies**.

In this context, we support a non-financial reporting regime that is:

- **Principles-based:** Reporting should focus on the most important factors affecting strategic and business model choices, as well as metrics that track the execution of these factors.
- **Focused on relevance for investors:** Building on this principles-based approach, requirements should focus on factors relevant to investors, with a clear distinction between requirements to provide data to certain relevant bodies versus what is included in the annual report.
- **Internationally aligned:** Greater international alignment will reduce reporting complexity for firms with multi-jurisdictional value-chains, and make UK capital markets and reporting more appealing to international users and markets. This offers a potential win for Global Britain: knowing that UK-based companies report against internationally-recognised standards will be a draw for investors.
- **Carefully implemented for proportionality:** Concessions should be made to reduce burdens for smaller firms, potentially descoping very small firms until tested with larger firms, while avoiding carve-outs that could create fragmentation.
- **Field testing:** consider undertaking field-testing of the current requirements to guide proposed changes and the scope of non-financial reporting.

Industry support for the International Sustainability Standards Board (ISSB)

Building on the above rationale, UK Finance and our members strongly support the work of the ISSB to build a global baseline for sustainability reporting. As both a preparer and user of sustainability reports, the financial services sector supports disclosure of sustainability-related risks, impacts and transition plans by firms, because this is critical to measuring exposure across lending and investing portfolios. For these disclosures to be meaningful, data needs to be consistent and comparable.

The arguments in favour of the ISSB standards in generating decision-useful information for investors and to support the efficient allocation of capital in the sustainable economy are well rehearsed. Drawing on the ISSB's own effects analysis[1], UK Finance supports the standards because they:

- Promote transparent capital markets that better reflect the cost of sustainability-related risk, and support transition and adaptation efforts.
- Contribute to long-term financial stability by revealing information that will enable informed decision-making and management of sustainability-related risks.
- Avoid costs and reduce inefficiencies of manual data collection and analysis of sustainability disclosures, through greater consistency, comparability and verifiability of information.
- Help generate higher quality information from companies that are in the value chain of a reporting company, which in turn can have a positive effect on areas such as governance, strategy, access to capital, cost of capital, reputation, and employee and stakeholder engagement.

Sustainability disclosure rules need to be globally coherent. Many firms operate across jurisdictional boundaries and will be users and preparers of standards from multiple sources, including the EU, US, UK and international standards bodies. Common adoption by these jurisdictions of the ISSB's IFRS 1 and IFRS 2 standards would greatly reduce fragmented disclosure requirements and complexity for preparers and investors alike. Such interoperability should ultimately allow organisations to better measure and manage risks related to climate and broader sustainability issues and will help to ensure an orderly and just transition. It would also encourage companies with less mature disclosure practices to improve, enhancing the information available to capital markets, and thereby their transparency. Ultimately, these will all have the effect of raising the quality of data and information needed in transitioning to a sustainable economy. We welcome efforts by global regulators to increase the availability of sustainability data, and the International Organization of Securities Commissions' (IOSCO's) recent

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[1] https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/effects-analysis.pdf

endorsement[2] of the ISSB standards on behalf of its members, which we expect will catalyse endorsement and implementation in 130 jurisdictions, covering over 95% of financial markets.[3]

We have welcomed UK support for the ISSB, and called on the UK Government to maintain its commitment to adopting the ISSB-aligned disclosure for a wide range of firms, on a proportionate basis, implementing the standards with minimal divergence and ideally without any carve-out. We therefore strongly welcome the UK Government's 2 August statement[4] that the UK Sustainability Disclosure Standards "will only divert from the global baseline if absolutely necessary for UK specific matters". We would urge the government to be clear about the nature of and justification for any proposed carve-outs, not least to give lenders and investors time to prepare.

As a leading financial services hub and integral part of international capital markets, the UK has a unique opportunity to play a leadership role in ensuring that sustainability disclosure requirements are globally coherent. In adopting the ISSB standards, it is likely to prompt other jurisdictions to follow suit. To maximise its influence over the decisions of authorities in other jurisdictions, we would strongly urge the UK Government to proceed with its own determination on ISSB endorsement and implementation as quickly as possible (we note, for instance, the Australian Treasury's proposals to begin requiring reporting against the ISSB standards from 2024).

Cost savings associated with mandatory application of the ISSB standards in the UK

To supplement the above principles-based argument for ISSB adoption, and to inform future cost-benefit analyses, we set out **four use cases** where we believe the mandatory application of the ISSB standards will offer net savings relative to alternative UK approaches.

For the purposes of this paper, we assume two possible counterfactual scenarios: if the ISSB standards are not adopted for mandatory reporting, either (1) the UK deploys no new sustainability reporting requirements or (2) the UK adopts its own, as yet unspecified, reporting requirements, or a sub-set of the ISSB standards. In both scenarios, our assessment is that adoption of the ISSB standards offers the greatest relative savings, notwithstanding the additional requirements introduced in the EU and the US.

The findings below draw on extensive, long-term engagement with our members on the ISSB standards, as well as a more recent informal qualitative survey of UK Finance members covering 10 firms from a broad range of categories including:

- UK-based firms with UK-focused operations, at large, mid and small size;
- UK-based firms with UK and international operations;
- UK subsidiaries of international firms based in the US, EU and Asia.

Use case 1: Cost savings associated with wide application of the standards, for both financial services firms and their clients

UK Finance argues for wide, proportionate application of the standards, since it is only with the data reported by a broad range of actors across the economy that financial services firms will be able to report on their sustainability exposures with accuracy, and that such disclosures will thereby enable the efficient allocation of capital in the sustainable economy.

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[2] I IOSCOPD741-Endorsement-Decision.pdf

[3] The IOSCO endorsement noted, with emphasis added: "After a detailed analysis, IOSCO has determined that the I**SSB Standards are appropriate to serve as a global framework** for capital markets to develop the use of sustainability-related financial information **in both capital raising and trading and for the purpose of helping globally integrated financial markets accurately assess relevant sustainability risks and opportunities...** IOSCO has found that the ISSB conducted a robust process and have concluded that **these standards serve as an effective and proportionate global framework of investor-focused disclosures on sustaina**bility- and climate-related risks and opportunities".

[4] https://www.gov.uk/guidance/uk-sustainability-disclosure-standards

To minimise costs, reporting requirements would ideally cover large, mid-sized and small firms, while acknowledging that reporting requirements for small firms need to be proportionate to their size and capabilities. (Such proportionality can be operationalised by introducing longer phase-in times rather than carve-outs.)

Without this wide application, firms will need to turn to estimates or external data providers to inform their disclosures. This will not only reduce the accuracy of firms' reporting, but will also incur costs. Of firms sampled, around two-thirds — covering larger, mid-sized and smaller firms — said that they would need additional resourcing if harmonised reporting requirements were not applied for a wide variety of economic actors; and a majority noted that they would need to employ external data providers. Incremental cost estimates for this additional resourcing were in the range of £0.5 million to £1 million per year for a larger firm, through both external data and internal resourcing cost.

A lack of harmonised standards creates an unlevel playing field and poses risks to competition and effective functioning of capital markets. We are already aware of instances in which banks, due to the requirements imposed by third countries or their investors, are compelled to ask their clients to report sustainability exposures across different reporting standards. This could result in a barrier to competition, with customers having to recollect or resubmit data to meet different needs with the associated costs of changing reporting reducing the propensity to change bank. These implications will be significantly exacerbated for SMEs who have more limited resources to cope with this unnecessary burden.

Use case 2: Cost savings for firms adhering to other international regimes

Reporting requirements are being rolled out across multiple jurisdictions, particularly in the EU (via the Corporate Sustainability Reporting Directive (CSRD) and the European Sustainability Reporting Standards (ESRS)) and the US (via the Securities and Exchange Commission's (SEC) climate risk reporting requirements). We found that some 90% of sampled members, a mix of large, mid-sized and smaller firms, that would be subject to UK sustainability disclosure rules would already be required to disclose under one or more of these other international regimes, either through legal requirements in those jurisdictions or the expectations set by investors, regulators and local market practice.

A decision to implement an approach that differs from the global ISSB standards would add another regime to the existing complex landscape, adding to compliance costs for firms dealing with CSRD, US SEC disclosure, and ISSB disclosure in third countries. All sampled firms, other than one, told us that this could mean a need for additional staffing, in the region of 1-50 FTE (largely a function of the overall size of the firm's UK operation, acknowledging that staffing requirements were difficult to estimate without clarity on the UK's alternative operating model). According to respondents, the core reason for this additional resourcing requirement is that the loss of harmonised sustainability standards would result in reduced economies of scale compared with a scenario in which the ISSB standards are required. Additional non-FTE costs would also be generated by the need to utilise different systems and adjust processes for internal and external assurance, senior management engagement and review across the whole organisation.

Use case 3: Cost savings in light of existing sunk costs

Many firms, particularly large and mid-sized firms, have already allocated significant resourcing to prepare for disclosure against the ISSB standards in light of previous statements made by the Government on the planned implementation of those standards. Of the firms sampled, this was true for approximately two-thirds. The firms tell us that this resourcing includes: recruitment of specialist accounting and sustainability professionals with understanding of the reporting requirements; training and development to build capability among existing and new staff; and structuring teams, governance and reporting lines to enable the flow of reporting within the organisation.

A decision not to implement the ISSB standards widely for use in the UK would mean that much of these costs was misplaced, and that additional costs would be incurred to recruit and retrain staff and make reporting, risk management system and related changes.

Firms have also engaged closely on the development of the ISSB standards, including dedicating time and resources to responding and contributing to the ISSB's and UKEB's consultation on ISSB Exposure Drafts in mid-2022; supporting the development of methodologies on which the ISSB standards were based (e.g. Sustainability Accounting Standards Board standards); and iteratively commenting on and providing expert input into the standards at other junctures in their development. This commitment has amounted to expenditure of several millions of pounds over an extended period for both larger and smaller firms.

If the UK chooses to adopt a different reporting standard or a sub-set of the ISSB standards, firms will need to dedicate similar resourcing to the development of that standard, through consultation, engagement with standards-setters and testing. This is a highly resource-intensive project which will add to firm costs, and is inadvisable at a time when the implementation of such standards for their stated objectives is urgent. The pipeline of new initiatives and consultations in green finance regulation is extremely busy over 2023-24, and it would not be advisable to add another initiative particularly when a fit-for-purpose model for sustainability disclosures, endorsed by the main securities body, IOSCO, already exists.

Use case 4: Lack of benefits from departing from international and global standards

A decision by the UK Government to loosen its association with the ISSB standards by choosing not to implement them or to implement them with carve-outs would reduce our ability to influence global standards over the long run. The ISSB currently looks to the UK as a leader. An inability to influence the standards will be a significant disadvantage to UK firms, which will wish to continually iterate and engage the development of the standards as they are rolled out internationally.

If you have any questions relating to this note, please contact:
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