

Reform, governance and ESG

In her quarterly summary of latest IR industry developments, Liz Cole looks at the hot topics of market reform and reporting changes.

Policy continues to evolve at pace, with developments in all three broad areas of post-Brexit market reforms, corporate governance and sustainability reporting, with several more consultations expected before the end of the year. It promises to be a busy time for IR professionals.

Market reform

Unlocking capital for growth

In July, the chancellor delivered his keynote speech at Mansion House announcing a raft of proposals for UK financial services, including pension funds being permitted to invest up to 5% of default funds in unlisted equities, which would unlock up to £50bn of investment for high-growth companies and AIM companies.

An 'intermittent trading venue' will also be set up next year to allow private companies to access capital markets without floating on a stock exchange, which would provide liquidity for growth companies in the UK.

Short selling

As part of the UK government's push to repeal and replace retained EU law in financial services, the UK's short selling regime is to be reformed. The government sees short selling as an essential tool to facilitate effective market functioning, supporting liquidity, risk management and effective price

SEC cybersecurity rules

In July, the US Securities and Exchange Commission adopted rules requiring disclosure of material cybersecurity incidents and annual disclosure of material information on cybersecurity risk management, strategy and governance. The rules apply to SEC registrants, with foreign issuers required to make comparable disclosures.



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discovery. The government will retain the FCA's powers to intervene in emergency situations, but is promising several relaxations to the existing UK SSR framework for shares, including:

- raising the threshold for privately notifying the FCA of net short positions back up to 0.2%; and
- removing individual public disclosure of net short positions above 0.5%, and introducing an aggregated net short position disclosure on the relevant stock.

Investment research

It is welcome news that the government accepted all of the recommendations from Rachel Kent's *Investment Research Review*, with the FCA due to push ahead with removing the requirement to unbundle research costs by the first half of 2024.

A new 'research platform' will also be established to provide a one-stop-shop for firms looking for research experts, and a code of conduct will be developed to support issuer-sponsored research.

Corporate governance and reporting

New reporting requirements scrapped

The government has withdrawn its proposed new reporting requirements for large UK listed and private companies. These would have included an annual resilience statement, fraud detection/prevention statement and triennial audit and assurance policy, which followed from the 2021 white paper *Restoring Trust in Audit and Corporate Governance*.

Concerns were raised as part of the government's call for evidence on the wider reporting regime (outlined in *Informed*, issue 119). The government has now promised a new reform package that will 'deliver a more targeted, simpler and effective framework' for issuers and investors. These changes will need to be reflected in the proposed revisions to the Corporate Governance Code, some of which were based on the abandoned reporting requirements.

Society comments on the Code

The Society responded to the Financial Reporting Council's proposals to update the Corporate Governance Code, drawing

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on findings from recent member research on the proposed revisions that would be most relevant to IROs. The Society is generally supportive, but called for more flexibility and less prescription in certain areas (for example, giving the audit committee oversight of narrative and sustainability reporting), and for more clarity around disclosure of ‘usage’ of malus and clawback arrangements.

The Society has also identified several areas where more detailed guidance would be helpful, including ‘significant’ appointments for ‘over-boarding’ disclosure, and audit committee engagement with shareholders.

QCA code update

The Quoted Companies Alliance (QCA) is also updating its corporate governance code, which is used by nearly 90% of companies on the AIM market, as well as those on the Aquis Stock Exchange and other markets or pre-IPO. The QCA intends to publish the revised version this Autumn.

Late filing of digitally-tagged reports

A surprisingly high number of listed companies failed to meet the deadline for filing their digitally-tagged reports with the FCA’s National Storage Mechanism last year (despite this being a disclosure requirement), so companies need to ensure they build in sufficient time for the tagging process. The FCA has also now streamlined its rules for annual financial reporting in structured digital electronic format (XHTML), and creating a simpler and quicker process for staying up-to-date with generally accepted taxonomies in a new *Technical Note*. Issuers can find the FCA’s requirements in DTR4.1.

FRC review of corporate reporting

The FRC has set out its expectations for the coming reporting season amidst the current economic background of high inflation, high interest rates and ongoing economic uncertainty.

While the general quality of FTSE 350 corporate reporting has been maintained, the FRC report discusses various issues and overall expectations for 2023/2024, including that companies should take a step back to consider whether the annual report as a whole is clear, concise and understandable, with a robust pre-issuance review undertaken to consider issues commonly challenged by the FRC.

As part of the ongoing audit and corporate governance reform programme, the FRC extended its monitoring to review directors’ remuneration reporting, identifying issues relating to the clarity of targets and performance for awards of bonuses and long-term incentive plans, also noting that ESG targets linked to remuneration should be consistent with KPIs in the strategic report (with any differences clearly explained) and with narrative reporting in TCFD reports.

Sustainability/ESG and reporting

ESG data and ratings

As mentioned in the last issue, a voluntary code of conduct is being developed for providers of ESG data and ratings that will hopefully be helpful for members given the amount of time and resource IR departments spend on these agencies.

This principles-based code covers governance, systems and controls, management of conflicts of interest and transparency, and aims to raise standards until any FCA regulation is introduced. It will also cover any firms that fall outside the scope of potential future regulation. The Society commented on the draft code, drawing on the findings from the Society’s ESG data/ratings survey among our IRO members at Easter this year, which illustrated a level of dissatisfaction with the current quality of engagement between companies and ESG data and ratings agencies.

The latest FRC Lab report on ESG data usage examines how investors obtain and use ESG data on companies, highlighting actions companies can take to facilitate

this, including publishing data sheets containing all ESG metrics in one place to facilitate third-party and investor data collection.

This allows annual reports to focus on the ESG risks, opportunities and progress that are material to the business, with strong interconnectivity between narrative and data reporting remaining critical to maintain credibility.

The report, *ESG Data Distribution and Consumption*, also refers to the findings from the Society’s ESG survey examining IRO experiences with ESG data and investors/raters.

Climate-related reporting

The FRC’s thematic review of climate-related disclosure found room for improvement, especially in relation to metrics and targets and the disclosure of the effect of climate change on financial statements.

Key findings show an incremental improvement in the quality of companies’ disclosure of net zero commitments and interim emissions targets. However, disclosures of concrete actions and milestones to meet targets were sometimes unclear, and comparability of metrics between companies remains challenging.

Meanwhile, two reports have been issued by the UK Endorsement Board (UKEB) aiming to improve the connectivity of climate-related reporting between sustainability-related financial disclosures and financial reporting accounting standards. One provides a deep-dive analysis from an investor’s perspective of potential connectivity challenges and includes stakeholder feedback on possible causes.

Transition plan disclosure framework finalised

The Transition Plan Taskforce (TPT) has launched its best practice disclosure framework for climate transition plans, aiming to provide a ‘gold standard’ for companies to develop and report on their nature-positive net-zero climate transition plans.

The launch of the new disclosure framework comes as companies globally are increasingly announcing net zero commitments, but have been lacking a

consistent, standardised way to report on these to stakeholders.

The framework suggests that periodic standalone reports be issued, which can include information that is not material to primary users of general purpose financial reports. Both the Department for Business and Trade and the FCA will consult on the extent to which companies should be required to follow the framework.

Nature-related reporting

Nature reporting has also taken a big step forward, with the Task Force on Nature-related Financial Disclosures (TNFD) issuing their final recommendations for nature-related financial disclosures last month at New York Climate Week 2023. The framework is modelled on the Task Force on Climate-related Financial Disclosures (TCFD) framework but it focuses on helping businesses assess nature-related impacts, dependencies, risks and opportunities.

The TNFD disclosure framework includes conceptual foundations for nature-related disclosures, a set of general requirements, and a set of recommended disclosures structured around TCFD’s four recommendation pillars (governance, strategy, risk and impact management, and metrics and targets), which should help enable integrated climate and nature reporting.

The taskforce has adapted the notion of Scopes 1, 2 and 3 in climate reporting to the nature context as ‘direct’ operations, ‘upstream’, ‘downstream’ and ‘financed’. The taskforce has also issued guidance on the use of scenarios for nature-related issues. If you are not sure where or how to start on your nature-reporting journey, Accounting for Sustainability (A4S) have issued some helpful guidance including a ‘maturity map’.

Upcoming consultations

It will be a busy Autumn/Winter as we expect consultations before the year end from the DBT on the introduction of:

- Scope 3 GHG emissions reporting,
- disclosure of transition plans, now that TPT framework has been finalised (see p11), and
- UK requirements for nature-related financial reporting, now that the TNFD framework has been finalised (see ‘Nature-related reporting’ on this page).

We also expect to see the FRC’s Stewardship Code review, to which record numbers are now signed up, representing £44.6tn assets under management.

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UK Sustainability Disclosure Standards (UK SDSs)

Following the DBT’s June call for evidence on the costs and benefits of non-financial reporting requirements for UK companies, the UK is pressing ahead with preparations for UK sustainability reporting requirements, with the government confirming in early August that corporates will be required to disclose the sustainability-related risks and opportunities that they face.

The formal UK endorsement mechanism to assess the suitability of the ISSB Standards for adoption in the UK had already begun, with the July call for evidence from the FRC. UK SDSs will be based on the ISSB’s standards, with the FRC examining their usefulness, technical feasibility and proportionality of costs to benefits.

FCA timetable for sustainability reporting requirements

The FCA is strongly encouraging listed companies to start considering the new ISSB standards and how to build them into their future reporting plans, announcing in PMB45 that it will consult in the first half of 2024 on the implementation of disclosure rules based on the UK SDSs and disclosure of climate transition plans (see above), with an aim for disclosure requirements applicable for financial years beginning on or after 1 January 2025 (with reporting from 2026).

The FCA envisages the same timescale for transition plan disclosure, based on the TPT Framework, and is therefore encouraging listed companies to ‘engage early’ and ‘get started’.

Internationalisation of SASB

Revised draft SASB standards have been published on SASB.org to allow stakeholders to familiarise themselves with the revisions. The changes are intended to help preparers apply the SASB standards regardless of their geographic location, operating footprint or applied GAAP, but do not substantially alter the SASB standards’ structure or intent.

Fatal flaw comments (i.e., any unacceptable defects that would seriously impair application) can be submitted until 10 November. The revisions will not be final until ratified and issued by the ISSB, anticipated in December 2023.

With over 3,000 companies in more than 70 jurisdictions, including 74% of the S&P Global 1200 Index, already applying the SASB standards, this initiative aims to ensure their ongoing effectiveness in supporting industry-specific sustainability disclosures.

EU sustainability reporting – CSRD limits increase and ESRs

The size limits for reporting under the Corporate Sustainability Reporting Directive (CSRD) have been increased, so fewer companies will now be caught. Meanwhile, in July, the EU moved a step closer to finalising its Sustainability Reporting Standards (ESRSs), with final versions being adopted by the EU Commission. Provided the EU Council raises no objections, the ESRs will apply for the 2024 reporting period, in time for the first tranche of companies that are required to report under CSRD.

A different set of standards will be developed for those overseas companies that operate in the EU and are due to start reporting in 2029 in respect of FY2028.

The ESRs have a ‘double materiality’ approach and cover the full range of environmental, social, and governance issues, including climate change, biodiversity and human rights, and will provide information to allow investors to understand the sustainability impact of the companies in which they invest.

The ESRs retain materiality assessments but with the definition of financial materiality being further aligned with the ISSB standards, to focus on primary users of financial reports. There is also implementation guidance on materiality assessments and value chain.

Assurance for sustainability reporting

For those considering assurance on sustainability-related reporting, progress is being made with a draft international standard out for consultation from The International Auditing and Assurance Standards Board (IAASB). Once finalised, the draft will serve as a comprehensive, stand-alone standard suitable for limited and reasonable sustainability assurance engagements, applying to sustainability information reported across any sustainability topic and prepared under multiple frameworks.

The standard will also be 'profession agnostic', so can be used by qualified accountants and other professionals with sustainability assurance engagements. Comments are due by 1st December.

EU SFDR and EU taxonomy

Turning to the requirements for asset managers, the EU is carrying out a far reaching review of the Sustainable Finance Disclosures Regulation (SFDR), which could result in the introduction of a labelling mechanism and/or more precise definitions of the product categorisations. Two consultation papers (one public and one targeted) seek views by 15 December on:

- the current requirements of the SFDR;
- the interaction with other sustainable finance legislation;

“ The SFDR review could result in changes to the ESG disclosure obligations for funds sold in the EU ”

- potential changes to the disclosure requirements in the regime; and
- the potential establishment of a new categorisation or labelling system for financial products.

This could result in changes to the ESG disclosure obligations for funds sold in the EU, given industry concerns on the costs and difficulty of compliance with the current rules. This could have a knock-on effect for reporting by issuers, given some corporates are publishing data on SFDR principal adverse impacts (PAIs).

UK SDR and investment labels

We also expect to see the FCA's long-anticipated policy statement on Sustainability Disclosure Requirements (SDRs) and investment labels in November/December. Meanwhile, some independent guidance has been published

Diversity in finance

The FCA is also consulting again on a new regulatory framework on diversity and inclusion (D&I) in the financial sector (CP23/20), with comments due by 18 December. This aims to establish minimum standards, greater consistency and transparency across the sector. The proposals include requirements to:

- develop a D&I strategy setting out how the firm will meet its objectives and goals;
- collect, report and disclose data against certain characteristics; and
- set targets to address under-representation.

A policy statement on final rules is expected in 2024, with an implementation date 12 months later.

on the design and implementation of a UK 'green taxonomy'. This seeks to draw lessons from the issues around the EU's SFDR and EU green taxonomy, also recommending a reporting template to facilitate consistent disclosure and provide a comparable metric for investors. An initial voluntary 'testing period' for at least two reporting years is expected, during which the template could be road-tested. ■

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