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16th August 2023

Dear The Department for Business and Trade,

ShareAction response to Smarter regulation non-financial reporting review: call for evidence

I am pleased to respond to the Smarter regulation non-financial reporting review on behalf of ShareAction, a registered charity established to promote transparency and responsible investment practices throughout the financial services sector. We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 26,000 individual supporters. Among other activities, we work with the financial services sector, including asset management firms, to promote integration of sustainability factors in investment decisions, long-term stewardship of assets and the consideration of the views of clients, beneficiaries and pension scheme members.

ShareAction welcomes the government taking a fresh look at the body of requirements companies need to comply with to ensure that the UK's corporate reporting framework continues to deliver what investors and other stakeholders need to support economic growth and long-term value creation. We strongly agree that non-financial information prepared by companies is useful, but with new international developments, such as The International Sustainability Standards Board (ISSB) global reporting framework, a review and integration strategy is necessary.

In addition to integrating the ISSB standards, in order for the UK's corporate reporting framework to advance and continue to guide decision-making, companies need to inform users of how they will take action to tackle wider social issues, in particular health, not just climate-related issues. It is crucial that users have access to health-related reporting because poor health exposes investors and many of the businesses they are invested in to elevated and preventable financial risk.

We have answered the relevant questions below. Please do not hesitate to contact us if you require any clarification on specific points.

1. **To what extent do you agree or disagree that non-financial information prepared by companies is useful?**

We strongly agree that non-financial information prepared by companies is useful. It is used for a wide variety of reasons and by different audiences. Users of non-financial information are broader than shareholders and include employees, the local community, suppliers, and other stakeholders. This information provides reassurances and guides decision-making. For shareholders, this information is crucial for their stewardship activities.

It is widely accepted that the private sector has contributed to social harms, such as poor health, racial injustice, and inequality. We view this broader information as an opportunity for companies to inform users of how they will take action to tackle wider societal issues, in particular health issues which are most often determined by the quality of people's jobs, the types of products they consume, and the quality of air that they breathe.

Economic output is strongly linked to population health. Improving health can add $12 trillion to global GDP by 2040, an increase of 8%.[1] However, the economic costs of air pollution are estimated to lead to 1% of global GDP loss by 2060 due to reduced labour productivity, health expenditures and crop yield losses.[2] The effect that ill-health has on the economy is huge, and users of non-financial information, such as diversified investors, need to be informed on company impacts on health. This is because market performance (affected by system risks like health) determines up to 94% of portfolio returns[3], and in addition, the extent to which companies are externalising negative health costs also relates to the level of regulatory risk they face. For example, food manufacturers over reliant on the sale of unhealth foods face risk of sugar taxes, marketing restrictions and enforcement actions.

While we do agree that it is useful, the reports need to be consistent and show data across multiple years, which allows for the those leading and lagging to be identified. Once the relevant data is identified, it needs to be linked back to the impact on the company and how it affects company strategy. The numbers alone do not provide the necessary information to make an informed investment decision.

2. **How does non-financial information support your judgement in the following areas?**

    a. **How the directors of the company have fulfilled their duties;**

In the Companies Act 2006 section 172, it defines how a director of a company must act and key matters they should focus on. There are also reporting requirements that are now connected with it under the Companies Act. The s.172 statement is required to be in the strategic report section of the annual report; therefore, it should relate to matters that are of strategic importance. A statement that s.172 has been considered is not enough. Effective reporting on s.172 needs to address how the issues that are important to a company's long-term success have been considered.

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[1] Remes, J. et al. (2020). Prioritizing health: A prescription for prosperity. McKinsey Global Institute. Available online at: https://www.mckinsey.com/industries/healthcare/our-insights/prioritizing-health-a-prescription-for-prosperity

[2] OECD. (2016). The Economic Consequences of Outdoor Air Pollution. OECD Publishing, Paris. Available at: https://doi. org/10.1787/9789264257474-en

[3] Jon Lukomnik and James P. Hawley, Moving Beyond Modern Portfolio Theory: Investing that Matters (April 30, 2021) Routledge.

We strongly believe that expertise on a comprehensive range of sustainability factors must be available at Board level. We also strongly believe that companies should incorporate a wider range of sustainability factors, including health, in their strategies and decision-making. Companies can begin by linking climate-related strategies to health-related strategies. For example, air pollution is often linked to greenhouse gas emissions, which is a risk that is more likely to already be embedded in corporate strategy.

If the s.172 statement is written correctly and answers the 'how,' then this is a very streamline way for the directors to publicly signal to other companies, investors, employees, and other stakeholders the importance of health-related issues being built into the directors' strategy. However, without this information, investors are unable to assess whether directors are appropriately mitigating company risks if the relevant data is not reported. Such data would include the proportion of sales coming from unhealthy and increasingly regulated products.

b. The performance of the company;

The performance of a company is a holistic calculation combining financial and non-financial information. The non-financial information can still have a financial impact on the company.
Good health is a driving force for economic prosperity, but poor health exposes investors and many of the businesses they are invested in to elevated and preventable financial risk. The Office of National Statistics (ONS) UK Labour Force Survey shows that the sickness absence rate in 2022 was the highest it has been since 2004. An estimated 185.6 million working days were lost because of sickness or injury.[4] Improved population health would lead to a decrease in the number of sickness absences, which would boost productivity, increase labour supply, and reduce healthcare expenditure.

Even with these financial impacts, if health considerations are included in assessments, the focus tends to be on policies rather than measures of real-world performance. For example, an assessment might look at whether a company has a policy or commitments in relation to health and nutrition, but not at metrics on sales, product formulation, precarious work, or low pay. The lack of comparable data is cited as a reason why real-world performance is not factored into the assessments of companies.

Data on companies' health-related impacts, practices and relevant risks is limited, incomplete and poor quality. Company disclosure on health lags significantly behind disclosure on environmental topics. For investors, this lack of comparable data makes it difficult to meaningfully assess internal and external health-related risks and direct stewardship accordingly. That is why non-financial reporting can be such a vital tool if it provides concise, focused information. It is designed to link the company's health policies to the company's performance now and in the future. Then the real-world performance can be factored into the assessments of companies.

c. The company's future strategy, opportunities and risk;

Non-financial reporting provides valuable insight into the company's future strategy, opportunities and risk. This can be a tool for protecting and promoting corporate reputation. However, there is often limited capacity within ESG teams to keep investors up-to-date on regulatory developments

[4] Office of National Statistics. (2023). Sickness absence in the UK labour market: 2022. Available at: https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/labourproductivity/articles/sicknessabsenceinthelabourmarket/latest

and consumer trends most relevant to health. This creates a scenario where financially material regulatory trends can easily be missed.

Increasingly, government and consumer expectations around public health exposes companies to regulatory, reputational, and litigation risks, all of which can have a material financial impact on businesses. New regulations or even just regulatory pressure can hinder or accelerate a company's growth. Governments around the world are acting on health, including regulations on tobacco and sugar taxes. More than 50 countries have implemented taxes on sugar sweetened beverages, which is significantly more than the number of global carbon taxes.[5] Shifting consumer trends toward healthier products also generate reputational risks, as the public is more aware of the negative role manufacturers can play in influencing their dietary choices. It is crucial that users have access to health-related reporting because poor health exposes investors and many of the businesses they are invested in to elevated and preventable financial risk.

d. The company's approach to societal issues such as modern slavery and the gender pay gap;

As we have outlined, in addition to having a positive impact on society, investors that take account of health considerations may also see improved profits. This is also true of other social factors, such as work to reduce the ethnicity pay gap. Gender pay gap reporting has been mandatory for companies with over 250 employees since 2017. Despite evidence of vast discrepancies in pay that exist between ethnic minorities and White British workers, there is no equivalent legislation to monitor pay disparity for workers of different ethnicities. ShareAction, supported by the Runnymede Trust, produced an investor toolkit and will be working with a coalition of investors to ensure that companies have robust procedures in place for EPG reporting.

The ethnicity pay gap (EPG) shows the difference in the average pay and bonus pay between ethnic minority colleagues and white colleagues across an organisation irrespective of role and seniority. This is different to equal pay, which is the legal requirement to pay the same to people who are doing work of equal value. EPG disclosures are a critical step for identifying and tackling inequality in the workplace. The McGregor-Smith review found that 'if BME talent is fully utilised, the economy could receive a £24 billion boost' annually and 1.3% to GDP. Yet, only a tiny fraction of FTSE 100 companies are reporting their ethnicity pay gap. ShareAction recently published an investor briefing and toolkit which examines the links between narrowing the ethnicity pay gap and good investment returns.[6]

We see mandatory ethnicity pay gap reporting as a critical step to reducing workplan inequality while providing a boost to the UK economy. Specifically, the Government can take several steps to address this issue:

- **Legislate for mandatory EPG reporting for employers with 250+ employees.** This would ensure that employers report on employees' ethnicity, broken down into the most

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[5] World Health Organization. (2022). WHO calls on countries to tax sugar-sweetened beverages to save lives. Available at: https://www.who.int/news/item/13-12-2022-who-calls-on-countries-to-tax-sugar-sweetened-beverages-to-save-lives

United Nations Climate Change. About Carbon Pricing. Available at: https://unfccc.int/about-us/regional-collaboration-centres/the-ciaca/about-carbon-pricing

[6] ShareAction. (2023). Ethnicity Pay Gap Reporting. Available at: https://shareaction.org/reports/ethnicity-pay-gap-toolkit

appropriate categories and quartile pay bands, in addition to the overall pay gap. EPG reporting should become a key part of a company's DE&I culture.

- **The new legislation should require employers to publish a supportive narrative and action plan to combat any disparities.** Simply publishing an EPG report is not enough. Rather than focusing on a single set of final figures, our findings emphasise the importance of producing a supporting narrative explaining the context as well as an action plan, setting out how to tackle any identified gaps, as is recommended by the CIPD.

The government guidelines only state that companies should 'consider' publishing a narrative and action plan. We argue that a supporting narrative and action plan are essential requirements and support employers contextualise their data. Our research showed that these steps are as important as the figures that are revealed and that companies welcomed the opportunity to explain what might otherwise present as problematic figures, and to develop wider explanation for their remedial actions.

- **The government should provide additional guidance on the data disaggregation targets and, as recommended by the Women and Equalities Committee, release guidance explaining:**
  - Data protection to reassure employers as to how they capture, retain and report data
  - Methods for capturing, analysing and reporting data
  - The powers of the enforcement body responsible for monitoring EPG reporting

Alongside legislation, the government should provide an expanded package of support for companies, such as employer case studies to demonstrate best practice and factsheets developed by the relevant bodies, such as the Government Equalities Office. Learnings could be adopted from the rollout of gender pay gap reporting.

Reporting on ethnicity pay gaps is not a simple cut and paste exercise, therefore guardrails ought to be put in place on how to implement it. Government should provide the tools and support necessary to enable companies at different stages of data integrity to be able to collect and disaggregate data to the best of their ability. This also supports some element of standardisation across sectors so that we can move towards some level of comparability.

Additionally, taking the workforce along on the journey will be crucial to ensure high self-disclosure rates and therefore meaningful reporting. Guidance will be necessary to support effective communication and allay any fears or misconceptions.

- **The government should conduct a 2-year on progress review.** To ensure EPG reporting is impactful, the government should commission a review of how organisations, companies and investors are progressing after two years.

3. **What changes, if any, would you like the UK Government to make to the current legal requirements for companies to prepare non-financial information, and why?**

Firstly, reporting on broader societal and ethical issues is an important component in producing decision-useful information for use by investors, wider stakeholders, and by the board of directors of companies themselves. While each new requirement has led to an increase in the size and complexity of annual reports, the value this information provides should not be reduced to simplify reporting requirements. The focus should be on the quality of useful information provided, which may not require a complex, lengthy report. Further, reporting should be tailored to each company's individual circumstances, but the law should reflect the need for social reporting to be prioritised to the level of climate reporting.

As there was a need for global transparent financial-related sustainability disclosures by companies, the International Sustainability Standards Board (ISSB) is aiming to develop those standards that will result in a high-quality, comprehensive global baseline for investors and the financial markets. The ISSB has published its first two standards: S1 - the General Requirements standard and S2 - the Climate standard. We are calling for the ISSB to prioritise developing a social standard, specifically covering human rights and human capital, which would encompass workplace health, worker well-being, right to a healthy environment, and access to healthcare.

The UK Government recently signalled support for the ISSB and announced that it would be establishing a mechanism for formal UK endorsement and adoption of the standards.[7] The government should set-out clear expectations of industry to enhance its health-related disclosures and further regulation to encourage this reporting and ensure its quality and consistency.

Secondly, we see a clear need for legislative reform to enable directors to look beyond profit and make longer term decisions that align the interests of all stakeholders. These changes should be reflected in non-financial reporting. Section 172(1) of the Companies Act 2006 defines the purpose of a company as serving the interests of shareholders. It requires directors to prioritise shareholders' interests. This is typically interpreted conservatively and narrowly in practice to mean shareholders' relatively near-term financial interests and the market has developed norms which reinforce this interpretation. Directors are also not obliged to give any independent weight to wider societal or stakeholder interests.

The wording of s.172(1) requires simply that they 'have regard' to the listed stakeholder interests but stops short of imposing any further reaching obligation. This means that companies can choose to undermine wider interests, if this is in shareholders' interests especially where these are measured in the near-term only. This means that many directors are constrained by the law from doing what is right and necessary and understand their obligation to prioritise the financial interests of shareholders above all other factors. This legal context impedes long-term thinking and undermines a dynamic and agile economy-wide transition to net zero. The requirement for large companies to make statements explaining how s172(1) duties have been carried out does not change the underlying duties of directors solely to advance shareholders' interests.

Reporting is retrospective and companies, particularly larger companies have performed poorly in making these statements in recent years. Supporting economic growth and long-term value creation whilst meeting climate targets will require more forward looking, agile decision making and reporting. We suggest that non-financial reporting should require directors to prepare a coherent statement explaining how they have aligned the interests of all stakeholders.

4. **Thinking about the future of your organisation and the UK's transition to a net zero economy, what changes, if any, do you think may be required to the type of non-financial information produced to guide decision making, and why?**

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[7] FCA. (2023). FCA welcomes launch of ISSB standards. Available at: https://www.fca.org.uk/news/news-stories/fca-welcomes-launch-issb-standards

We see three key regulatory interventions necessary to support the UK's transition to a just, nature-positive transition:

The Government should require companies and investors to disclose the environmental and social impacts of their activities by introducing sustainability disclosure requirements. It was a huge step backwards when the Government withdrew plans to require such disclosures ahead of the Queen's speech in 2022.[8] While strong progress has been made by the FCA in driving forward new sustainable investment labels, with final rules expected to be published this autumn, little to no progress has been made around corporate and investor sustainability disclosures. The Treasury rightly outlined the virtues of the SDR regime in the Roadmap for Sustainable investing, following the Prime Minister's announcement at the 2021 Mansion House speech, in particular that it would 'for the first time, bring together existing sustainability-related disclosure requirements under one integrated framework – building on leading global standards and best practice – and go further with new requirements… SDR will use the same framework and metrics across the economy to ensure a clear and direct link from investors, through the financial system to the businesses they are invested in and their relationship with the environment.'[9] SDR being withdrawn from last year's Queen's speech represented a significant missed opportunity to support the UK's just and nature-positive transition and the Government should ensure it forms part of this year's King's Speech and the relevant legislation is introduced ahead of the next election.

The Government and financial regulators should support ongoing efforts to build reporting frameworks focussed on "S" and the Government should signal its intention to integrate these frameworks into the UK's regulatory regime. The Taskforce on Inequality-related Financial Disclosures is designed to be used by companies and investors to measure and manage both systemic risk and systematic portfolio risk arising from social issues. TIFD also aims to build support from regulators and policy makers for reducing inequality that damages economic performance.[10] It is widely accepted that the private sector has contributed to social harms, such as poor health, racial injustice, and inequality. Despite private sector impact, there is currently no disclosure framework that accounts for the systemic economic and financial risk that the inequality outcomes of business practices pose. Once this work is complete, the FCA should integrate social factors, including health, into the ESG sourcebook and work should be undertaken to require companies and investors to report against the TIFD framework.

The Government and FCA should support integration of ISSB standards in the UK, focusing on human rights and human capital. One of the more concerning aspects of the development of ISSB standards so far has been too much of a focus on environmental issues at the expense of social ones. The Government and FCA should explicitly call for the inclusion of social issues, specifically human rights and human capital, into the ISSB framework. We outline our views on the importance of the integration of ISSB standards into the UK regulatory regime below.

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[8] Financial Times. (2022). Ministers delay plans to force UK corporate environmental disclosure. Available at: https://www.ft.com/content/2c5acee3-e900-4b2e-853d-85b10e13629c

[9] HM Government. (2021). Greening Finance: A Roadmap to Sustainable Investing. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1031805/CCS0821102722-006_Green_Finance_Paper_2021_v6_Web_Accessible.pdf

[10] Task Force on Inequality-related Financial Disclosures. (2022). Frequently Asked Questions (TIFD FAQ). Available at: https://static1.squarespace.com/static/5eac34e7e4a3db64662f3134/t/6331fc10e065b46dd7e1a109/1664220176593/TIFD+FAQ+Version+3.0.pdf

5. **How should the standards being prepared by the International Sustainability Standards board (ISSB) be incorporated into the UK's non-financial reporting framework?**

ShareAction strongly supports the introduction of ISSB into UK regulatory frameworks. Having global baseline standards and comparable data across jurisdictions is critical for investors to help identify opportunities and mitigate risk. We welcome DBT's approach to the NFR review by recognising broader audiences to corporate data than just the shareholders. Investors, consumers, suppliers, workforces, regulators and broader society are all stakeholders to corporate performance. However, in general terms the ISSB standards are only relevant to investors since they focus exclusively on financially material sustainability factors.

We are calling on the Government to go further than solely introducing ISSB and strongly encourage it to introduce reporting requirements against the GRI standards, in addition to ISSB, which are more relevant to broader stakeholders. Not only do the GRI standards form the basis of the EU's reporting regime, meaning significant alignment with EU-based financial institutions, they also give considerable focus to business impacts, supporting the Government's ambitions to become the world's first net-zero financial centre. There is substantial overlap between ISSB and GRI and we consider the two sets of standards to be complementary and would give a more comprehensive picture of a company's sustainability performance. In addition, the GRI standards are voluntary, so wouldn't necessarily provide added burden to companies not wishing to report against it. **We therefore recommend the Government introduce the ISSB standards into UK regulatory frameworks and endorse the GRI standards.**