

‘The Future of Narrative Reporting’ IIGCC’s Response to the UK Department for Business Innovation and Skills (UK BIS) Consultation

Introduction

We appreciate the opportunity to respond to your follow-up consultation on corporate narrative reporting and welcome with this continued engagement alongside other consultations on greenhouse gas emissions reporting.

As a forum for collaboration between institutional investors across Europe on issues associated with climate change, we believe it is important that companies manage these risks in a way that ensures that they deliver long term value to those who invest in them. Providing clear statements in companies’ Annual Report and Accounts on their strategies to address these risks and opportunities and, where material, performance data on greenhouse gas emissions is an important step in informing investors and providing them with the information they need to make decisions.

Evidence suggests that companies are not always fully reporting this information. We encourage them to do so and in an effort to improve reporting practices in carbon intensive sectors, IIGCC has developed a series of sector-specific disclosure frameworks that set out reporting best practices for electric utilities, automotive and oil and gas companies.

Revising the narrative reporting framework does offer an opportunity to provide more clarity to directors on what they should be considering for inclusion in the Annual Report and Accounts. However, we believe that changes to regulation are only one of a number of mechanisms that are needed to ensure that companies are providing information to investors on the risks and opportunities that climate change presents to the long-term sustainability of the business. Sector-specific guidelines are an important element to make this information more relevant for investors. Indeed more regulation might in some circumstances encourage further defensive reporting which would be counter-productive and fail to deliver a more meaningful depiction of risk for investors. Many of the issues in corporate reporting stem from norms entrenched within the organisation which cannot be addressed by regulation alone.

Specific questions relevant to IIGCC / Investors

Question 1 (relevant to IIGCC)

Do you agree in principle with restructuring the current reporting framework into a Strategic Report and an Annual Directors' Statement?

In principle, as investors, we have no broad objections to the restructuring as suggested; our main focus is on ensuring that the nature and quality of narrative reporting in annual reports and accounts is improved. We do have some concerns however that these changes will be seen as a complete solution to some of the issues that currently exist with narrative reporting, and that they may in fact reduce clarity of reporting in some areas.

The focus of our interest is on the risks and opportunities associated with climate change and strategies to address these. In some respects we welcome the move to develop a more structured approach to narrative reporting, but are concerned that splitting the information in the way suggested may risk exacerbating the already existing issues of clarity and comparability of this information, with data duplicated across the report and some of the key information not available in a single document. We also have some concerns that whilst structure is helpful in terms of ensuring that consistent information is reported, it should not be overly prescriptive, thereby restricting a company's ability to report on what it deems to be material to its future prospects.

In response to the original consultation on narrative reporting, many investors stated that annual reports had already become marketing statements. We do have some concerns that presenting the information contained within the annual report and accounts in the manner suggested carries the risk that companies may take this even further.

In order to make fully informed investment decisions we need clear data on companies' direct and indirect greenhouse gas (GHG) emissions, supported by concise narrative providing evidence that the company has a clear strategy to deliver year on year reductions. Additionally, we want information on adaptation strategies demonstrating management of the financial material risks that climate change presents (e.g. extreme weather events) while seeking to maximise any related opportunities to deliver long-term value. It is our concern that the investment community is able to obtain this information in a clear and comparative way. For example, it is foreseeable that the suggested restructuring may result in the information being split between the two sections of the annual report.

Question 2 (relevant to IIGCC)

Do you agree that the Strategic Report should include information on:

- *company performance*
- *principal risks and uncertainties*
- *key performance indicators*
- *key financial information (similar to that currently required for the Summary Financial Statements)*

and for quoted companies should include:

- *strategy*
- *business model*
- *environmental and social information,*
- *key information on executive remuneration and its link to performance?*

For listed companies it is critical that shareholders and other key stakeholders have access to clear information on the key financially material risks and opportunities a company is facing, and the actions it is taking to manage these.

The development of pricing mechanisms for carbon makes the disclosure of GHG emissions an increasingly important aspect to consider when examining corporate performance. Investors need to be fully informed with clear disclosure on corporate environmental performance and evidence that the organisation is both minimising and mitigating the risks associated with climate change and other environmental impacts and at the same time maximising any opportunities for delivering increased shareholder value that these issues present.

We would highlight the same issue raised in response to question 1, with concerns for how key information on GHG emissions and risks will be delivered in the suggested structure. Clear quantitative data supported by narrative explanation should be presented within the annual report and accounts, and signed off by directors. Our concerns are focused on the fact that from an investor's perspective, rather than making annual reports easier to understand and use, there is a risk that this information which should be given an increasing priority will be pushed onto the company website and lost amongst the range of data on there.

Under the current narrative reporting regime we are not seeing full disclosure of greenhouse gas emissions data, even by those organisations where their direct emissions may represent a material financial risk to the long term success of the business. We welcome the move to improve clarity around what should be included within the Annual Directors' Statement including removal of boilerplate disclosures. Additionally, we note the reference to accommodating mandatory GHG emissions reporting – should the decision be taken to do this. However, we have concerns that the manner in which the changes are proposed could confuse the Annual Directors' Statement by duplicating information from the front end of the annual report and combining a range of voluntary disclosures and web links to further data with little clarity or assurance on the content. From an investor's perspective this could lead to a very confusing picture on corporate performance, particularly regarding information such as GHG emissions.

While structural changes to the framework for annual reports and accounts may be helpful, we do not believe that this is the fundamental solution to the issue of underreporting of GHG emissions or the risks and opportunities associated with climate change in a broader sense and therefore offer the following recommendations. Under the existing reporting regime the Business review should include, "where appropriate, analysis using key performance indicators including information relating to environmental matters" and for those companies that are listed "to the extent necessary for an understanding of the development, performance or position of the company's business" ensure the Business Review includes information on "environmental matters", This needs to be properly enforced, in addition companies need to clearly demonstrate that they are making an assessment of all the issues that are relevant to their strategic development and growth including those of environmental, social and governance concern.

Our concerns are focused on the fact that we do not believe that all companies are properly recognising the financial implications of climate change and fully reporting this information to investors. Whilst changing the reporting structure could help, we believe that more effort needs to be directed at educating directors and companies on the risks that issues, such as climate change, represent and ensuring that the requirements currently set out in the Companies Act are being followed. The end goal of this will be that climate change becomes more integrated into companies' strategies and risk management: as such it is important that directors are mindful of reporting meaningfully on strategy and materiality. They should not be restricted by burdensome reporting requirements that do not allow them to communicate most effectively or that encourage them towards further defensive and boilerplate reporting.

Question 5 (relevant to IIGCC)

Do you agree that the Annual Directors' Statement for quoted companies should include:

- *disclosures required, regardless of materiality, by the Companies Act, the Listing Rules etc.*
- *the Corporate Governance Statement*
- *the Directors Remuneration Report*
- *financial information (for example, post-balance sheet events etc)*
- *information provided voluntarily by companies (for example, additional environmental and social disclosures)?*

We would refer to our responses to Questions 1 & 2.

Question 6 (relevant to IIGCC)

Do you agree that companies should be able to include material in the Annual Directors' Report (for example information on policies and procedures) by cross reference to information published elsewhere (for example on the company's website)?

The Annual Report is a key document that should contain all the information necessary for an existing shareholder or potential investor to review the historic performance and future strategy of a company. Whilst reference to more detailed information contained elsewhere on particular topics is acceptable, the risk of allowing too much information to be presented in this way will be to devalue the Annual Report itself.

IIGCC Membership November 2011

Amundi	Impax Asset Management
AP1 (First Swedish National Pension Fund)	Insight Investment
AP2 (Second Swedish National Pension Fund)	Joseph Rowntree Charitable Trust
AP3 (Third Swedish National Pension Fund)	Kent County Council Pension Fund
AP4 (Fourth Swedish National Pension Fund)	Kleinwort Benson Investors
APG Asset Management	Legal & General Investment Management
ATP	London Borough of Hounslow Pension Fund
Aviva Investors	London Borough of Islington Pension Fund
Baptist Union of Great Britain	London Borough of Newham Pension Fund
BBC Pension Trust	London Pensions Fund Authority
Bedfordshire Pension Fund	Low Carbon Investors Pte Ltd
BlackRock	Merseyside Pension Fund
BMS World Mission	Mercer Global Investments Europe Limited
BNP Paribas Investment Partners	Northern Trust
BT Pension Scheme	Nordea Investment Funds
CB Richard Ellis	Osmosis Investment Management
CCLA Investment Management	PGGM Investments
Central Finance Board of the Methodist Church	PKA
CF Partners (UK) LLP	Platina Partners
Church Commissioners for England	PRUPIM
Church of Sweden	Railpen Investments
Climate Change Capital	Robeco
Co-operative Asset Management	Sampension
Corporation of London Pension Fund	Sarasin & Partners LLP
Dragon Capital Group Ltd.	Schroders
Earth Capital Partners	Scottish Widows Investment Partnership
Environment Agency Pension Fund	South Yorkshire Pensions Authority
Environmental Technologies Fund	Temporis Capital
Ethos Foundation	The Church of England Pensions Board
F&C Management Ltd	The Church in Wales
Generation Investment Management LLP	The Roman Catholic Diocese of Plymouth
Greater Manchester Pension Fund	The Roman Catholic Diocese of Portsmouth
Grosvenor Fund Management	The Roman Catholic Diocese of Salford
Henderson Global Investors	United Reformed Church
Hermes	Universities Superannuation Scheme
HgCapital	West Midlands Metropolitan Authorities Pension Fund
HSBC Investments	West Yorkshire Pension Fund
Hudson Clean Energy Partners	William Leech Charitable Trust