5th February 2021

Sir Jon Thompson
Chief Executive Officer
Financial Reporting Council
125 London Wall
London, EC2Y 5AS

Submitted by e-mail to: futurereporting@frc.org.uk

Dear Mr. Thompson,

CFA UK response to the FRC regarding the Discussion Paper on the Future of Corporate Reporting

The CFA Society of the UK (CFA UK)[1] is delighted to have the opportunity to share its views on this consultation paper. CFA UK formed a working group of volunteer CFA charterholders to write this response letter; they have surveyed our members to inform this response and conducted a series of short interviews with some members. The team were grateful for the series of webinars which the FRC organised to explain and discuss the proposals.

Your proposals in the main concern (i) the increasingly important arena within Corporate Reporting of Non-Financial Information ("NFI") and (ii) proposes how companies' annual Reports & Accounts ("R&A") could be further developed to best present this ever-increasing volume of information. CFA UK welcomes this opportunity to consider a "root-and-branch reform" and create a corporate reporting framework that can indeed accommodate R&A users' developing requirements over the next 10 or so years - whilst placing a reasonable, justifiable and affordable burden on companies.

Out of necessity the investment world is undergoing a major upheaval in a drive to measure, analyse, understand and respond to ESG risks which in turn can only be measured through the regular and consistent reporting of NFI. CFA UK and CFA Institute are playing their part in this process, but it must be emphasised that this new level of analysis can only be realised if underlying issuers provide the relevant and necessary information in a useful way[2].

CFA UK believes that fit-for-purpose corporate reporting should provide consistent and comparable NFI to help institutional investors allocate capital in a way which safeguards their

[1] CFA UK's mission is to help build a better investor profession for the ultimate benefit of society. We refer you to Appendix I for a brief overview of both CFA UK and our umbrella organisation, CFA Institute.

[2] CFA UK launched its Certificate in ESG Investing in 2019. More than 5,000 individuals (around 62% from the UK) have registered for the exam. CFA UK is also planning to launch a similar qualification specifically on the issue of climate change in investment. CFA Institute is currently developing a set of ESG Disclosure Standards for Investment Products. These standards aim to provide a common global framework by which the ESG focus and/or activities of all pooled funds will be capable of being described to end investors and other stakeholders in standard and universal terms.

clients' investments as much as possible from ESG risks, such as climate change or poor governance[3]. With the help of new technological developments, it should also help to improve access to capital for those companies working to mitigate those impacts. Equally, good NFI reporting should result in capital becoming scarcer and more expensive for those companies and activities most exposed to ESG risks.

Since 2006 the CFA Institute and CFA UK have campaigned against "corporate short-termism" – a phrase that refers to an excessive focus on short-term, periodic measures of income to the detriment of long-term value creation. In 2015, CFA UK published a thought leadership paper on Termism[4] that concluded: "we do not live in a world where market prices always reflect fundamental value; company management can manipulate earnings, capital can be misallocated and risk can be mispriced." Indeed, the long term is a series of short terms, but value creation over the long-term should be the 'north star' to guide decisions and actions. In 2020 the Institute reconvened a panel and issued a new report. Two of the report's recommendations were:

> Issuers and investors should both make meaningful investments in engagement to foster increased discussion around the long-term issues most important to a company's strategy.
>
> Issuers and investors should establish better standards around ESG data so that the data are consistent, comparable, and audited as well as material. [5]

The FRC's proposals resonate clearly with these aims. In particular, we welcome the emphasis on enabling users to understand how a company sustainably creates long-term value in accordance with its stated purpose, as well as the intention to place NFI on a level playing field. Not all of our members in the investment community are mandated to invest for the long-term, yet this philosophy underpins our advocacy on professionalism, ensuring that the intermediation of capital works in the public interest. As we set out below, the issue of materiality is complex, but a simple improvement on the current regime may be to link materiality to the *long-term* consequences of decision-making.

More focus on reporting NFI may also help investors assess the long-term value of intangible assets, such as brand, which have come to dominate many successful business models to the point where traditional valuation metrics may be presenting an incomplete picture. At the same time, while we are supportive of elevating the importance of NFI, we must emphasise the importance of integrated reporting to our members. It would be very helpful if financial and NFI were equally accessible, internally consistent and equally focused on value and risk.

Corporate reporting is widely accepted as a factor which influences corporate behaviour. Sections two and three of the discussion paper refer briefly to this idea, but it seems to us foundational to the entire project: corporate reporting is not an end in itself. We suggest that the FRC brings it into the foreground, making more explicit how reporting requirements may influence corporate

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[3] CFA UK and CFA Institute seek to educate and advocate widely on stewardship, ESG and climate change issues in so far as they affect investment. We are pleased to provide a list of CFA UK's other recent consultation responses in these areas as Appendix III.

[4] https://www.cfauk.org/professionalism/research-and-position-papers/termism#gsc.tab=0

[5] Matt Orsagh, Jim Allen & Kurt Schacht. *Short-termism revisited: improvements made and challenges in investing for the long-term*. CFA Institute (2020). p.4

(and investor) behaviour, how that behaviour meets the collective interests of the major stakeholders, and what the related risks may be. For example, exempting unlisted companies may inadvertently reduce the number of public companies; or too great a distinction between the information reported in the business report and the public interest report may cause management and investors to downgrade the importance of NFI and engagement with ESG matters.

A team of CFA UK members with a strong interest in corporate reporting, and with experience as both preparers and users of R&As, have collaborated to write this response letter. In Appendix II they have provided some context around the professional standards required of CFA charter holders and described some of the roles performed by our members to indicate how they increasingly rely on good NFI and corporate reporting. The team has also worked to produce our detailed responses to most of the specific questions in your consultation paper, and these are set out in Appendix III. Our response has been shaped by the results of a CFA UK membership survey[6] and some in-depth interviews with representatives from financial intermediaries and investors.

In our survey, roughly two-thirds of respondents comprised of analysts and portfolio managers, whilst one-third were preparers of accounts, corporate relationship managers and a number of other minority stakeholder groups. On the main issues there was consistent agreement across the issues:

- 85 per cent of respondents (88% of analysts and portfolio managers) agreed that companies should be obliged to report NFI in their annual R&A;
- 91 per cent of respondents using R&As to make investment decisions or recommendations, either "always" or "often" incorporate NFI in those decisions and recommendations;
- 75 per cent of respondents using R&As to make investment decisions or recommendations agreed that both data reliability and non-comparability hindered the integration of NFI into their analysis of companies; and
- 82 per cent of respondents (83% of analysts and portfolio managers) supported the FRC's proposal to generate a network of three company reports as an enhanced corporate reporting solution.

Whilst these findings reflect the strong majority of the respondents' views, we also share the views of a reasonable minority that you may wish to consider in your deliberations. These members are:

i. doubtful NFI can be made useful and comparable given the diversity of company activity;

[6] To support and guide the responses in this letter, the CFA UK working group conducted a survey (https://www.surveymonkey.com/results/SM-W6HMF2Y57/), sent to the entire membership of CFA UK, addressing the subject matter and questions within the FRC's Discussion Paper. This survey received 89 responses, representing just under 1% of members.

ii. deeply concerned about the cost and management resource implications that these additional reporting requirements place on companies and/or believe that publishing a public interest report should be voluntary and not mandatory;

iii. object to the perceived unnecessary change and/or additional workload involved with moving to a 3-report network because they believe the information is either presented elsewhere already or because they are concerned about the separation of information.

We note that this is a Discussion Paper and that you intend to consult further on more detailed proposals. CFA UK looks forward to participating on that/those consultations and to meeting with you as users of accounts in advance of any consultation if that is helpful. We do wish to encourage the FRC with its ambitious and progressive reform, however, we would underline that the success of the 3-report format (which our members evidently currently support) will depend on the effectiveness, technological logistics and practicalities of the links between them. If these links were to prove ineffective, information could become more siloed and at greater risk of omission from our members' analysis. If poorly implemented, this proposal could therefore be a hugely retrograde step and a matter of major concern for our members.

Lastly, we also observe that the overall strong support of our members for these proposals reflects the direction and pace of new regulations which will likely require our fund managers to report on sustainability measures at the fund level going forward. It would be helpful if the FRC could engage with the FCA on this matter to ensure consistency.

Should you have any questions or points of clarification regarding this letter or our responses to the questions, do not hesitate to contact us.

Yours sincerely,

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With thanks to contributions from:

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and the oversight of the Professionalism Steering Committee.

APPENDIX I: About CFA UK and CFA Institute

CFA UK serves nearly twelve thousand leading members of the UK investment profession. Many of our members work with pension funds, either managing investment portfolios, advising on investments, or as in-house employees responsible for pension investment oversight.

- The mission of CFA UK is to build a better investment profession and to do this through the promotion of the highest standards of ethics, education and professional excellence in order to serve society's best interests.
- Founded in 1955, CFA UK is one of the largest member societies of CFA Institute and provides continuing education, advocacy, information and career support on behalf of its members.
- Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.
- For more information, visit www.cfauk.org or follow us on Twitter @cfauk and on LinkedIn.com/company/cfa-uk/.

CFA Institute is the global association for investment professionals that sets the standard for professional excellence and credentials.

- The organisation is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and economies grow.
- It awards the Chartered Financial Analyst® (CFA) and Certificate in Investment Performance Measurement® (CIPM) designations worldwide, publishes research, conducts professional development programs, and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry.
- CFA Institute has members in 162 markets, of which more than 170,000 hold the Chartered Financial Analyst® (CFA) designation. CFA Institute has nine offices worldwide and there are 158 local member societies.

For more information, visit www.cfainstitute.org or follow us on Twitter at @CFAInstitute and on Facebook.com/CFAInstitute.

APPENDIX II: Context to our responses to the questions

The CFA UK supports CFA Institute by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society. This includes maintaining the public's trust in financial markets and in the investment profession.

One of the CFA Standards of Professional Conduct, germane to climate change disclosure, is:

> "Members and Candidates must:
> 1. Exercise diligence, independence, and thoroughness in analysing investments, making investment recommendations, and taking investment actions.
> 2. Have a reasonable and adequate basis, supported by appropriate research and investigation, for any investment analysis, recommendation, or action."

We therefore wish to see corporate reporting being of practical use to investment professionals.

CFA Society members are present in many types of firms and in a variety of professional roles. Some examples will bring this to life:

Supporting fair valuation
Objective valuation of equity and debt instruments by investors is essential for robust capital markets. Valuation disciplines require the forecasting of cash flows, the determination of risk premia and discount rates, comparability across companies, etc., and material upside or downside due to ESG risks needs to be reflected in valuations. Research analysts and sell side brokers will be particularly interested in understanding ESG risks and opportunities faced by the firms that they cover.

Disclosure and transparency
As the asset management industry gears up for greater transparency on ESG, the quality of information it provides will depend on what is reliably and consistently available from the underlying issuers of equity and debt into which its funds invest.

Incorporation in portfolio construction
Consistent data and metrics on ESG, and disclosure of the same, will feed into the portfolio construction process and allow better incorporation of ESG risks and rewards into the process. As some ESG factors (e.g. climate change) are seen to be largely a non-diversifiable risk, it could have a material impact on risk expectations.

Fund design
A better understanding of ESG will assist the investment process of equity and debt funds while facilitating the construction of appropriate fund mandates reflecting, for example, any constraints on ESG risks and impacts. ESG-oriented funds, needless to say, will benefit even more from meaningful disclosure.

Stewardship & Engagement
Improved ESG disclosures will enable analysts and portfolio managers to raise ESG issues much more effectively with company boards where they are a matter of concern. This engagement could then also extend to the tabling and voting on well calibrated and focused ESG related resolutions at company AGMs.

APPENDIX III: Responses to questions

Here we provide our answers to the 12 questions of the FRC's discussion paper, adding context from the interviews and the survey we conducted where pertinent.

Q1 **What is your view on our proposals as a whole? Are there elements that you prefer over others?**

CFA UK As set out in our covering letter, we support the FRC's endeavour to change the future of corporate reporting. We particularly like the prominence given to NFI reporting because many of our members want to integrate ESG matters into their investing or reporting processes but find it difficult due to inconsistent approaches to reporting and data presentation.

Significantly, we believe, the periodic profit-focused "primary user" no longer fully reflects the needs of investment professionals on which the concept was based.

Comparability is important to analysts and an awareness of international reporting regimes and NFI accounting standards such as the Sustainability Accounting Standards Board's (SASB) would be helpful. We would recommend you consider also referencing well-understood international frameworks such as the UN's Sustainable Development Goals (SDG) and the Taskforce for Climate Related Financial Disclosures (TCFD) as these are important to and used by many of our members.

If the inadequacies of the current reporting regime – in particular its focus on short-term periodic profit – can be attributed in part to the *unsubstantiated* needs of the mythic "primary user", these proposals should avoid repeating the same mistake. We believe the FRC will have to substantiate the needs of the multiple stakeholders the new regime intends to serve through objective-driven reporting. If this is not done, we believe there is a very real risk that the Public Interest Report will become too unwieldy, which is a major concern of our group.

That said the FRC should consider carefully the complex matter of materiality as well as the current or foreseeable feasibility of data collection. We would welcome a focus on providing information that affects *long*-term decisions. The FRC should first seek inputs from management, auditors, industry trade bodies, investors and other stakeholders. We have reservations about giving management too much flexibility. Moreover, 'garbage in, garbage out' could thwart the FRC's broader intentions. In our view, the FRC must ensure that the reporting requirements introduced are of high importance to stakeholders, although we understand that from a practical perspective it may be necessary to

phase in some reporting requirements over a multi-year period to ensure a high feasibility of data collection.

CFA UK and the CFA Institute promote stronger engagement on sustainable value creation over the long-term as well as more effective stewardship and governance on matters relating to shareholders and other stakeholders. We therefore strongly support the re-oriented objectives of the Business Report. We support the introduction of multiple, objective-driven reports, as long as they are sufficiently networked and discourage financial and non-financial matters to be considered in siloes as they often are today.

The discussion paper alludes to creating a blueprint up to 2030. We hope that the proposals would not take that long to implement. The majority of users we surveyed and interviewed clearly want change to come sooner. We acknowledge that the proposals represent a big change, but the issues covered by NFI are too important to wait another full decade. In comparison, companies have been given just five years before the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) become mandatory in 2025. We expect the fiercest push-back from companies to be in relation to the cost of implementation. In our opinion, as long as companies are given reasonable time to prepare and, if proportionality is applied, we believe that investing to improve corporate reporting could lead to better returns on capital over the long term. In particular, a failure to invest in better reporting could lead to a higher cost of capital and potentially poorer management decisions also.[7]

Q2 **What do you see as the key practical challenges of implementing our proposals? Do you have any suggestions on how these could be overcome? What do you see as the costs and benefits of the new model?**

CFA UK The FRC's proposal includes a number of changes to the current system of corporate reporting, including a stronger emphasis on NFI and the addition of the Public Interest Report, a split of the annual report into separate objective-driven reports for various groups of stakeholders, and a more advanced use of technologies for user access and information processing. These changes will clearly place additional burden on companies, especially in the beginning. We support the principles of taking a proportional approach, as we set out under

[7] Cf. Robert Eccles, Ioannis Ioannou and George Serafeim, 'The Impact of Corporate Sustainability on Organizational Processes and Performance', *Management Science 60*, no. 11 (2014): 2835-857

Q11, and a phased approach to implementation whereby the scope of the reporting requirements is progressively rolled out to smaller companies.

We expect the additional costs of implementation of the new system to be more than offset by the benefits of companies becoming more transparent to all of their stakeholders in line with the ongoing evolution of society's view on the role and responsibilities of business. We also envision that improved transparency is likely to lead to a lower cost of capital. In addition, the use of new technologies can lead to lower costs of data processing for companies in the long run.

Another key practical challenges that we foresee is ensuring consistency between company accounts. This is one area where the current system is failing and, arguably, by expanding the reporting requirements consistency could become even more difficult to achieve. Strong and clear standards for auditors, supported by both effective advisory/training services in these new areas of reporting and a credible monitoring and sanctions regime seem essential.

Finally, as shareholders are ultimately bearing the cost of the additional reporting, CFA UK would not be supportive of a reporting regime which led to the production of irrelevant and 'hobby-horse' data to satisfy the interests of groups that cannot be accurately described as stakeholders in a company. Cost/benefit analysis needs to be rigorously applied when reviewing the information requested by third-parties which are not obviously direct stakeholders in the company concerned. If the information serves no useful purpose then shareholders should not be asked or expected to pay for its collection or reporting.

Survey & Interviews

The main challenge that came up both in the survey and in interviews is related to limited resources, especially at smaller companies. There is strong support for phased and / or limited implementation, with small firms having lower reporting requirements (see our answer to question 11 on Proportionality).

Among the benefits of the proposed changes, 82% agree with splitting the annual report into three new reports. Stronger requirements for companies to provide NFI is also viewed as a benefit, with 85% of the respondents voting for it. The expansion of reporting to cover the needs of all stakeholders is supported by 58% of the respondents – the slightly lower percentage may indicate reservations about precisely what "all" stakeholders might mean.

Q3 **Should corporate reporting focus on a wider group of stakeholders through multiple objective-driven reports, instead of a primary user focused approach?**

CFA UK We support moving away from the "primary user" focused approach. Although dominant for the last fifty years, that "user" was more deduced than induced, and their "needs" presumed but largely unsubstantiated. Nevertheless, they formed the basis of assumed norms that elevated the importance of short-term periodic income as a measure of corporate success. Even before we consider other stakeholders, this "primary user" approach no longer fully reflects the requirements of the investor community, on which it was originally based. Even those of our members who still believe corporate reporting should primarily serve the shareholder mostly support the formalised introduction of public interest reports. Analysts would welcome changes to corporate reporting that facilitate greater engagement with long-term strategic issues, the sustainability of a company's growth model, and its "reason for being" in society.

As long as the reports are sufficiently networked, interconnected and speak to one another (this is a "must"), we support the FRC's proposal to mandate multiple objective-driven reports. If they are not interlinked, there is a danger that financial and non-financial concerns could be siloed – sustainability reports at present rarely dovetail neatly with the annual report, analyst presentation and financial statements, for example. This would be unhelpful for investment analysts who increasingly need to consider both. With that in mind, we particularly like the proposal to consolidate various aspects of value creation in the Business Report (BR), making it stake-holder neutral, with the objective of enabling better understanding of long-term value creating process in accordance with a firm's stated purpose. Current voluntary disclosures are not transparent and their objectives unclear: there is too much scope for cherry-picking and 'green-washing'.

We hope that the FRC's proposals here would also foster greater uniformity and comparability on matters of public interest, which is currently thought to be lacking.

Survey 33.7% of survey respondents agreed with statement 1 below, while 58.4% of respondents agreed with statement 2.

1. The primary purpose of corporate reporting is to inform a company's capital providers with regular information that they require in order to

assess the company's ability to provide a satisfactory and sustainable economic return on the capital provided.

2. The purpose of corporate reporting is to inform a range of key stakeholders (e.g. employees, suppliers, customers, government, regulators) with regular information, which they require to remain supportive stakeholders for the company. No single user of the report should be considered primary.

Interestingly, a large majority of respondents that agreed with statement 1 went on to support other FRC proposals, such as the production of three objective-driven reports, as well as the obligation to report on NFI. In other words, even though they regard capital providers as the prime user of company accounts, they are still in favour of the proposals in your discussion paper.

Interviews

The analysts and portfolio managers we interviewed all supported the proposal of multiple-objective driven reports. Reporting on and being measured against matters important to a broader set of stakeholders was regarded by them ultimately as "good for business over the long-term". Firms that push back on the "cost" of reporting are failing to see this as "R&D", for example bringing improved customer loyalty or staff engagement that will lead to a lower cost of capital and/or higher returns on capital in the future.

Our interviewee from the sustainability-reporting arm of a global accounting firm thinks that it would be useful to have a single report summarising the key information for all relevant stakeholders, while more detailed information useful to non-shareholders could be consolidated into another report sitting alongside the first one. In other words, they support the introduction of a public interest report which consolidates information needs of non-shareholders into a single report rather than the introduction of different reports for various stakeholders. According to them, insofar as NFI reflects the impact of the business on stakeholders across the value chain, it would be hard to meaningfully segregate this information in different reports, and considerable thought would need to be given to this.

Q4

Do you consider the set of principles (system level attributes, report level attributes and content communication principles) in section 2 would be helpful in improving the quality of corporate reporting today and in the future?

CFA UK — We support the attributes and communication principles proposed, which should help reports to fulfil the requirements set out by the Corporate Governance Code and The Companies Act 2006.

Interviews — "Connectivity", "Consistency", and "Transparency" were words that came up repeatedly in our interviews, unprompted by us. There is a clear desire for improving upon the current model.

Q5 — **Do you agree with our proposals to improve the relevance and accessibility of information, involving more concise reports distributed across a reporting network?**

CFA UK — Decades of academic research have established the 'performativity' of accounting: that what you measure and how you measure it changes the behaviour of the subject being measured. In this light, to encourage companies to consider relevance by asking "Will the information affect company behaviour?" and "Will the information affect decisions and assessments of the users?" is a good development. However, if companies are afforded *too* much flexibility the FRC's overarching aims may be thwarted.

The current approach to reporting NFI does not facilitate measurement or comparison. Companies have too much discretion. We welcome the FRC's proposals to improve the relevance of information, but we urge it to carefully consider the feasibility of gathering information related to the broader set of stakeholders – a greater quantity of lower quality information is not helpful to investment analysts.

We believe the FRC should also consider any reporting changes in a global context, aligning with overseas policy makers where possible. In terms of proportionality, this would help companies report the same (or very similar) information across jurisdictions. Furthermore, alignment with well-recognised frameworks such as the UN's SDGs should also improve relevance and accessibility.

Statistics on the very low percentage of annual reports that actually get read are well known. We would hope that more concise, focused and relevant reports should improve accessibility and better ensure that the information reaches its intended users. Use of comparable and consistent NFI integrated with financial reporting may encourage more users to make more intensive use of a company's Annual Report instead of mainly relying on computer-generated financial metrics downloaded from one of several available third-party data-providers.

Concise, focused and networked reports should also help the investment community engage with management on all issues in a clearer and more consistent manner. Currently, even relatively more ESG-mindful management teams often fail to make adequately tangible links between matters of "business" and "public interest", and the FRC's proposals could help here.

Survey

We asked our members to rate on a scale of 1-10 the extent to which current annual reports contain sufficient information for their purposes. The weighted-average score as 6.7, suggesting our members believe that the current reporting regime may not be meeting its requirements. Interestingly, the scores given by users and preparers of accounts were very similar. Isolating the 34% of respondents who believe that the primary purpose of corporate reporting is to inform providers of capital, the weighted average was only a shade higher at 7.3. Most interestingly, 83% of this cohort supported the idea of producing the three separate but interlinked documents proposed by the FRC. 82% of *all* survey respondents supported this proposal. The 18% who did not, rejected the proposal for a wide range of reasons. Some were ideologically opposed to reporting requirements, believing that the concept of the Public Interest Report is a "fad". Others raised concerns about data availability and the likelihood of companies reporting consistent and meaningful data in the public interest. Others believed that it would be better to include all of the innovations in one report, to ensure that all stakeholders can spot potential inconsistencies and so that the objectives are all integrated. Finally, some raised concerns about proportionality and materiality/cherry-picking that we comment on below.

Interviews

A manager of a global sustainable equity fund made it clear that if they cannot access a minimum standard of relevant information from a firm they will not invest. Given the trillions of dollars flowing into ESG-related investment strategies, it is essential reporting frameworks consider this. He pointed out that Scandinavian countries are doing good work on linking company information to the UN's Sustainable Development Goals, which he finds helpful. A credit analyst and bond fund manager also pointed to France's 2019 law, which mandated a company to state and report on its "reason for being" in society, as successfully encouraging firms to deliver relevant and accessible information to other stakeholders. We note that the UK Corporate Governance Code also requires companies to explain their 'Purpose', but that this is for now on a 'comply-or-explain' basis.

Q6 **We are proposing that there should no longer be a single test for materiality that is based on accounting standards but instead materiality will be dependent on the objective of a report. Do you agree with this approach, please explain why?**

CFA UK We consider the question of materiality to be one of the most complex issues as well as one of the most contentious. This was evident in the interviews we conducted as part of our research. It is clear that our members believe that material information is missing from today's corporate reports, especially in relation to social and environmental impacts and externalities. As such, placing too much discretion in the hands of management may not lead to much improvement and could thwart the FRC's aims. We conclude that a collaborative engagement between management, auditors and stakeholders is required. However, as collaboration cannot always be taken as a given, methods to encourage this (e.g. introducing safe harbours) should be promoted.

Reference to industry-specific benchmarks would help comparability. Industry trade bodies could be engaged to assist with this, the creation of standards or guidance. Given our view on proportionality, we expect these proposals to affect multinational corporations more than others, and so an international perspective on materiality would be welcome, facilitating greater comparability.

One innovation that we would particularly welcome would be to link materiality more explicitly to the long-term and long-term decision-making. Information should be considered material if omitting, misstating or obscuring it could reasonably be expected to (wrongly) influence the decisions that the users of the report (shareholders, customers, employees, suppliers, local community in which it operates) make on the basis of that report that would have long-term consequences for value creation and the public interest.

We welcome the proposal to ask companies to disclose the basis on which materiality judgements have been made, detailing the process as much as the final decision with reference to quantitative and non-quantitative benchmarks, where possible. On the latter, referencing well-established frameworks such as those provided by SASB (also linked to the UN's SDGs) would be helpful. Communicating the time horizon considered for materiality is also a smart proposal.

Survey The complexity of this issue did not lend itself to coverage in our multiple-choice answer survey, so was not addressed directly. However, two respondents did mention materiality specifically when given the opportunity to provide written

responses to other questions. One respondent believed that materiality should be linked clearly to "*long-term sustainable value creation*" across all reports. The second respondent believed that materiality must consider what is material to each company.

Interviews

All three investment analysts/managers agreed that missing material information is a big problem currently and cautioned against giving management too much leeway. One equity analyst suggested that since this is a 10-year mission, the FRC might consider an iterative process which first tries to establish a consistent approach to materiality first in a priority area, for example, climate change.

Our interviewee from the sustainability-reporting arm of a global accounting firm suggested that materiality is too company-specific and industry-specific when it comes to NFI for regulators to pronounce on it. A generic benchmark is not appropriate. Even SASB and the other sustainability standards providers are far from aligned on materiality. They felt it should be left for companies to decide and 'common sense' should prevail. Auditors audit materiality and provide consulting services, and market-mechanisms would penalise companies that 'cheat'.

Q7

Do you believe that there is a need for regulatory standards for non-financial reporting? If so, what do you consider the scope of the information that should be covered by these standards?

CFA UK

In the Discussion Paper, the FRC emphasise the importance of non-financial reporting, which is defined as "information relating to employees, suppliers, customers, the community, the environment and human rights". While the FRC acknowledge the existence of some regulations relating to NFI reporting, they also note the multitude of voluntary frameworks that creates a confusing landscape for companies and which results in a lack of relevant, reliable, comparable and balanced information for users. Therefore, in their proposal, the FRC consider the development of regulatory standards for NFI reporting. They believe that these regulatory standards should aim to produce NFI which is prepared with an equivalent level of rigour as financial information, balanced, consistent year-on-year and comparable across companies.

CFA UK's membership is largely supportive of the introduction of regulatory standards for NFI, the definition of which includes information relating to employees, suppliers, customers, the community, the environment and human

rights. We expected that the proposal would be supported by our members. The result of our survey is in line with this expectation.

We encourage the FRC to consider an industry specific approach in establishing the scope of these standards to reflect the way each industry operates. We highlight that the scope should at least cover key areas of interest that would apply to most industries such as climate change (including scope 3 emissions) and ESG impacts in supply chains of companies; data and metrics on these areas are arguably most challenging to collect, assess and compare across peers.

We note the recently published EU Taxonomy Regulation will require investment managers in the EU to provide sustainability related disclosures on investee companies. We consider that the EU Taxonomy Regulation could provide a useful reference guide for setting the scope for NFI reporting standards. We also refer the FRC to our response on question 9 that covers our views on the content for the proposed Public Interest Report.

Survey

As mentioned above, our members, through their responses to the survey, have shown support for the proposal to introduce regulatory standards for non-financial reporting. 85% of respondents believe that companies should be obliged to provide NFI, while only 15% of them are of the opposite view.

Notably, when asked about how often NFI is used in investment decision making process, 77% responded that they always or often integrate non-financial reporting consideration into their investment analysis. Of this 77%, 52% always do so. Only 1% of respondents said they never use NFI in their investment decision making.

Interviews

Our interviewees agreed that regulatory frameworks for non-financial reporting would be welcomed. One professional based at a large consulting firm noted that businesses are increasingly being asked by investors about NFI, and the “monetised value” of ESG-related information.

In addition, the same interviewee mentioned that a globally standardized framework would be ideal for multinational corporations, however, understanding the challenges and time required to develop such international standards, the interviewee believes that the FRC should press ahead with their non-financial reporting proposal.

A manager of a global sustainable equity fund noted that introduction of regulatory standards on NFI will drive increased accountability and minimise greenwashing. He noted that there are many companies that provide

information on philanthropic activities, which arguably diverts attention from key operational related matters.

In terms of the scope of information that is covered by these standards, the interviewee provided several examples of NFI in the Netherlands and the EU, in which companies are required to fairly identify stakeholders and the impact of the business on these stakeholders. Of course, the way in which reporting against S172 of the Companies Act has been required performs a similar function, though tangible evidence of its impact cannot be easily substantiated.

Q8 **Do you agree with the need for companies to provide information about how they view their obligations in respect of the public interest?**

CFA UK CFA UK's membership broadly agrees with the objectives and contents of the Public Interest Report proposed by the FRC. The members' views on the objectives and content of the Public Interest Report, through the result of our member survey, are discussed in Question 9.

Interviews As mentioned in question 7, one of our interviewees gave examples of companies in the Netherlands and other EU countries disclosing information about their stakeholders and the impact of the businesses on these stakeholders. According to this interviewee, by identifying relevant stakeholders and how their businesses impact these stakeholders, companies could demonstrate how they view their obligations in respect of the public interest.

As noted in the response to question 5, a credit analyst and bond fund manager referred to a law in France, which mandates a company to state and report on its "reason for being" in society; in doing so, this law encourages companies to assess their obligations towards public and society in general.

Q9 **Do you agree with the introduction of a Public Interest Report and the suggested content as set out in Section 6?**

CFA UK CFA UK agrees with the FRC's proposal to introduce the Public Interest Report.

We note that certain corporates provide sustainability reports/disclosures where they disclose their social, environmental and governance performance. For example, in the UK, quoted companies are required to provide a report disclosing annual greenhouse gas emissions, diversity and human rights under the Companies Act 2006 (Strategic and Director's Report) Regulations 2013. However, we note that current reporting frameworks on areas mentioned above

are limiting and do not adequately address the important question of assessing the impact of the business on the companies' wider stakeholders and on society.

Whilst we broadly agree with the FRC's suggested content in the Public Interest Report, we note the following: firstly, there is a risk of companies losing focus if they are obliged to report on many issues with respect to several stakeholders. There is a need, in our view, as recorded earlier in our response to question 2, to identify a group of key stakeholders and focus on provision of useful (industry specific metrics) and relevant content with respect to such stakeholders. The FRC could achieve this by engaging with relevant stakeholders, those with a genuine stake in the company, to determine their priorities on key issues that need to be addressed from the perspective of public interest.

Secondly, we highlight how critical it is that the links between the three reports - i.e., Financial Statements, the Business Report and the Public Interest Report – are truly effective. If not, users relying on material (say) in the Public Interest Report could potentially draw false inferences because they have not understood the business model and financial data in aggregate and draw their conclusions based solely on information provided in the Public Interest Report.

Survey

82% of the respondents to the CFA UK membership survey agreed with FRC's proposal to split the corporate annual report into three separate documents.

Those who did not agree, noted valid challenges, some of which we list out as follows: (i) the proposed model could make it harder to spot inconsistencies in information provided in multiple reports; (ii) companies may lose focus on key matters if the scope of reporting increases substantially and (iii) increased regulatory burden and additional costs. One member queried whether the proposed public interest report may be a political rather than an investor requirement.

Interviews

One of our interviewees, a sustainability consultant, who supported the introduction of the Public Interest Report thought it would be more meaningful and useful to integrate the Public Interest Report into a single corporate report rather than producing multiple reports for various stakeholders. Their view was that NFI captured the impact of the business on multiple stakeholders and that it would be hard to meaningfully segregate this information in different reports.

A manager of a global sustainable equity fund agreed with the FRC's proposal to split the current corporate report into three components though highlighted that there is a need to appropriately draw out salient points in the business report

and financial statements to link it to the Public Interest Report and thinks this could be achieved via the FRC's proposal on the reporting network. He also felt that UN SDG's were well understood in the market and could be used as a basis to define a framework for public interest reporting.

A credit analyst and bond fund manager suggested that the Public Interest Report should consider including information on externalities (e.g., carbon footprint and related risk management/mitigation actions of companies. They emphasised the need to develop standardised industry wide metrics that were meaningful and comparable across peers within a business sector.

Q10 **Do you see any other ways that current and new technology could be used to facilitate the proposed model, and support the system level attributes of corporate reporting identified in section 2?**

CFA UK The FRC's ideas are forward-looking in terms of providing new ways for companies and users to store, organize, process and access information. We see their vision as laudable. However, its implementation may require material efforts and resources from companies, so it should be carried out gradually and with proportionality in mind.

We see further technological development moving in the directions of alternative and big data utilization and more widespread use of API and other tools of data access and processing. These trends are relevant for both financial and, especially, NFI. We expect companies to disclose more of various new types of data in the future in response to demand from stakeholders for indicators of environmental, social and other aspects of their performance.

Survey We asked, "What technological solution promises to bring the most benefit to your experience with corporate reporting?" Respondents could select more than one option for this question.

Only 21% of the survey respondents are satisfied with the current technological solutions used in corporate financial reporting, and most of the suggestions made involved relatively minor improvements of the current reporting formats.

Almost half would like to be able to use web-based solutions to generate sub-reports. Another 31% voted for XBRL or another machine readability solution, which is the option proposed by the FRC. 38% would prefer to use other ways to access the data and / or self-assemble reports.

XBRL has already been used for many years in financial reporting and processing, especially in the US, so it seems to be a better tested solution. However, perhaps it would be worth consulting with experts in programming languages to ensure that a better solution is not missed.

Interviews

Not all users of corporate reports are themselves experts in new technologies, so perhaps the progress in this area should be rather pushed by companies and regulatory bodies than pulled by users. One interviewee drew our attention to the issues of data availability and quality, which vary by company, industry, region and topic. This is especially relevant for non-financial reporting. Unless these issues are resolved, adding new technological tools may have limited real benefit. On the other hand, companies that are able to collect and process alternative data sets should be able to offer their stakeholders new ways of looking at their business and its impact.

Q11

Do you agree that the model we propose will achieve a proportionate reporting regime for companies of different size and complexity?

CFA UK

CFA UK's membership is largely supportive of the principle of proportionate regulation. As such, we believe that the principle behind these proposals would be supported by our membership. However, our survey reveals a wide divergence of opinion as to where the appropriate boundaries should lie both in respect to the obligation to produce NFI (a Business Report) and a Public Interest Report. To be more precise about these thresholds, CFA UK would need to conduct further outreach work with its members.

Survey

On the subject of NFI, 15% believe the obligation should only lie with premium listed companies, 30% see the obligation should rest with all listed companies and a further 10% want the obligation to be enshrined in the Companies Act on all companies meeting the definition of a "medium-sized company" under S465 of the Companies Act. Together therefore a base of 55% agree that small companies should be exempt. The use of the Companies Act has its advantages because it maintains a level playing field between private and public companies and so should ensure that any new reporting obligations do not add further impetus to the so-called trend of de-equitisation (companies going private).

Of the remaining 45%, 28% believe all companies should provide NFI. The remaining 17% provide an interesting *"smorgasbord"* of opinions, as below, nearly all of which accept that small companies should be freed of the requirement up to a certain point:

- Small companies should be required to produce a statement of integrity and honesty about how they want their company to move through the world;
- The thresholds for the Wates Principles should be adopted;
- Only micro, non-listed companies should be exempt;
- Entities with more than £1 million in assets;
- Entities with listed debt or equity, regardless of the geographic location of the listing;
- By "common sense and practicality";
- Companies with a market capitalisation below £50m;
- Companies with a market capitalisation below £100m;
- All companies, if Directors consider the NFI is material.

On the subject of the Public Interest Report, 22% believe the obligation should only lie with premium listed companies, 26% see the obligation should rest with all listed companies and a further 8% want the obligation to be enshrined in the Companies Act on all companies meeting the definition of a "medium-sized company" under S465 of the Companies Act. Together therefore a base of 56% agree that small companies should be exempt or 48% that small and medium businesses should be exempt.

Of the remaining 44%, 30% believe all companies should provide a Public Interest Report. The remaining 14% provide a similar range of views a that described above for the reporting of NFI in a Business report:

- Any company should be required to produce one if so demanded by [20 or more] customers;
- The thresholds for the Wates Principles should be adopted;
- Entities with more than £10 million in assets;
- It should start like TCFD reporting, first with primary listed companies and then more progressively down into smaller companies over time;
- Companies with a market capitalisation below £100m;

- By "common sense and practicality", in response to a request at a shareholder AGM.

One respondent to the survey suggested no companies should provide one; another survey respondent suggested that it should be entirely voluntary; a third disagreed with the separation from the other reports.

Interviews

All of our interviewees agreed that proportionality was important and all accepted that the Public Interest Report should be for only the very largest companies. Views diverged as to where the threshold should be for NFI reporting. One interview suggested £400-500m market capitalisation; another suggested that it should be measured by sale or headcount whilst a third opined that this could be sector-dependent as NFI was much easier to gather in certain sectors and much harder in others.

Q12

What other areas do you see being necessary or relevant to the development of a model for corporate reporting that is fit for the future?

CFA UK

We believe that the proposal is sufficiently ambitious. If the proposals are taken forward, the project should give more explicit consideration to the feasibility of data collection.

APPENDIX III: Recent CFA UK regulatory response letters on financial reporting, corporate governance and stewardship

(located at https://www.cfauk.org/professionalism/advocacy/responses#gsc.tab=0)

Response to the FCA (CP20/3) 'Climate Change Disclosure Reporting'
(October 2020)

Response to CFA Institute 'ESG Standards for Investment Products'
(October 2020)

Response to DWP 'Taking Action on Climate Change' – improving governance and reporting by occupational pension schemes
(October 2020)

Response to the BSI (PAS7341) 'Responsible and Sustainable Investment'
(February 2020)

Response to the FCA consultation (CP19/15) "IGCs: Extension of Remit
(July 2019)

Response to the FRC and FCA joint discussion paper (DP19/1) 'Building a regulatory framework for effective stewardship'
(April 2019)

Response to FRC's consultation on the proposed revision to the Stewardship Code
(March 2019)

Response to FCA consultation CP19/07 on proposals to improve shareholder engagement
(March 2019)

Response to the Investment Association's consultation on sustainability and responsible investment
(March 2019)

Response to FCA Discussion Paper (DP18-08) on Climate Change and Green Finance
(January 2019)