# Mandating climate-related financial disclosures by publicly-quoted companies, large private companies and limited liability partnerships

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| **Lead department** | Department for Business, Energy and Industrial Strategy |
| **Summary of proposal** | The Government propose to introduce legislation that will make mandatory the reporting of climate-related financial disclosures by publicly-quoted companies, large private companies and limited liability partnerships. |
| **Submission type** | Impact assessment (IA) – 12 August 2021 |
| **Legislation type** | Secondary legislation |
| **Implementation date** | 06 April 2022 |
| **Policy stage** | Final |
| **RPC reference** | RPC-BEIS-5061(2) |
| **Opinion type** | Formal |
| **Date of issue** | 20 September 2021 |

# RPC opinion

| **Rating**[1] | **RPC opinion** |
|---|---|
| **Fit for purpose** | The IA provides a rationale for intervention and presents a good range of options. The analysis builds upon evidence gathered through a combination of stakeholder engagement and consultation. The direct impacts on business have been identified, allowing the RPC to validate the EANDCB figure. The proposals have no direct impact on small and micro businesses. The Department has committed to a post-implementation review (PIR). |

# Business impact target assessment

| | **Department assessment** | **RPC validated** |
|---|---|---|
| **Classification** | Qualifying provision | Qualifying provision |
| **Equivalent annual net direct cost to business (EANDCB)** | £145.3 million | £145.3 million *(2019 prices, 2020 pv)* |
| **Business impact target (BIT) score** | £726.6 million | £726.6 million |

[1] The RPC opinion rating is based only on the robustness of the EANDCB and quality of the SaMBA, as set out in the Better Regulation Framework. The RPC rating is fit for purpose or not fit for purpose.

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| **Business net present value** | £-1250.8 million |
| **Overall net present value** | £-1250.9 million |

# RPC summary

| Category | Quality | RPC comments |
|---|---|---|
| EANDCB | Green | The Department has accurately identified the direct impacts of the proposals. The IA makes use of an updated baseline/counterfactual, as a result of evidence gathered during consultation. Although no attempt has been made to monetise the benefits, this has been justified. The IA considers the costs and benefits to investors. |
| Small and micro business assessment (SaMBA) | Green | The IA states that no small and micro businesses (SMBs) are in scope of the proposals. It has, nevertheless, identified the likely number of SMBs on which the proposals will have an impact due to their status as a subsidiary and the requirements falling upon their parent group |
| Rationale and options | Satisfactory | The Department has used new research, and evidence gathered through consultation, to provide a clear and well-supported rationale. The IA does not discuss any non-regulatory options and would benefit from clearly explaining why none is suitable. |
| Cost-benefit analysis | Good | The Department has strengthened the IA’s evidence base through consultation and has updated its analysis accordingly. Calculations are clearly explained. The IA sets out well the assumptions made and has included sensitivity analysis relating to baseline factors. |
| Wider impacts | Satisfactory | The IA includes explicit discussion of the competition, distributional and trade impacts. The IA would be improved through some more-detailed discussion of the trade and investment impacts, as well as how the proposals may have an impact on innovation within firms and industry. |
| Monitoring and evaluation plan | Good | The Department has committed to undertaking a PIR of the policy and has demonstrated a significant amount of initial work on developing a monitoring and evaluation (M&E) plan. The IA could benefit from a refinement in the intention of M&E through a clear discussion of how the policy proposals will lead to the desired objectives. |

# Summary of proposal

The Government propose to introduce legislation that places requirements on the climate-related reporting of certain large UK businesses. The intention is to improve the rate and quality of the reporting in the UK, to enable companies to identify better their own climate-related risks, as well as inform investors better, while also having the potential to enable these firms to contribute to the UK's push towards net zero.

In addition to a do-nothing baseline, the IA includes three policy options for discussion, all of which mandate some degree of reporting, but vary in the depth required from the businesses in scope:

1a - Mandatory reporting with voluntary scenario analysis.
1b - Mandatory reporting, including qualitative scenario analysis (preferred option).
1c - Mandatory reporting, including quantitative scenario analysis.

The IA has highlighted the key areas of impact across businesses, investors and wider society. The primary areas of impact discussed and monetised are:

- familiarisation – one-off costs for businesses with the new reporting requirements;
  legal review – one-off cost for business to seek external legal advice;
- governance – ongoing costs for businesses establishing governance structures for climate related operations;
- strategy – ongoing costs to businesses of identifying the climate related impacts on their strategic planning;
- risk management – ongoing costs for businesses accounting for climate-related risks;
- metrics and targets – ongoing cost to businesses of developing and, then, operating metric reporting frameworks;
- cost to subsidiaries – ongoing cost for collecting and submitting relevant information to parent groups;
- cost to parent companies – ongoing cost of collating and processing relevant information; and
- cost to government – cost of producing and maintaining guidance.

The IA contains some qualitative discussion of potential indirect costs to investors, who may not be able to make full use of the new level of reporting without making adaptions. The IA discusses the benefits to investors, of being informed better about future decisions; society, of the potential climate improvements; and the reporting companies themselves, of understanding their climate risks better.

# EANDCB

**Identification of impacts**

The IA identifies several areas of cost that will fall upon all of those in scope of the proposals, introducing and monetising the key transitional and ongoing costs to firms. Estimates of costs vary depending on whether the business is a parent, group or a subsidiary.

Following stakeholder engagement and considering consultation responses, the IA includes costs for legal review.

The IA now also considers the potential indirect costs and benefits to investors, which were not discussed at the consultation stage.

The IA discusses (paragraph 96) the potential benefits to wider society, arising as benefits cascade through the supply chain. The IA should benefit from discussing whether there will be indirect costs on the supply chain, as a result of the businesses in scope needing to report (i.e. such as the potential of firms in scope being more likely to do business with those downstream capable of reporting, to facilitate their own reporting needs). However, as this would be an indirect impact, this would not affect the accuracy of the Department's EANDCB figure.

**Non-monetised impacts**

The IA discusses the benefits of the proposals but does not monetise these. This is likely to create an over-estimation of the overall impact on business. However, the Department has justified non-monetisation of these benefits due to the difficulty in quantifying them.

The RPC considers this to be appropriate and proportionate, given the difficulty in quantifying the direct result of the proposals taken forward.

**Accuracy of baseline/counterfactual**

The Department has updated the baseline and counterfactual since the consultation stage IA, to take account for new evidence gathered, which explains the level, and quality, of reporting currently made. This has led to a refinement in the number of businesses in scope and the number that already report to the expected new standards.

# SaMBA

The IA explains that no SMBs fall within the scope of the proposals. However, as a result of the presence of SMBs as subsidiaries within a larger business group, there will be an impact on some through requirements that will be placed upon their parent organisation.

The IA includes an estimate of the number of SMB subsidiaries on which the measures will have an impact, highlighting that these represent only 14 per cent of the total number of UK subsidiaries.

Within the analysis undertaken by the Department, the expected costs to subsidiaries, to enable the reporting of their parent organisation, are set out clearly.

While this analysis is carried out using an average cost approach, therefore not accounting for business size, in the specific SaMBA section of the IA, the Department states that the costs would vary by size with SMBs facing smaller costs.

# Rationale and options

### Rationale

The IA uses findings from recently-produced research on the current level of reporting being made by UK businesses, to establish the baseline position and to support the rationale for regulation. The IA identifies the negative externalities associated with not reporting, and the risk of assets being stranded, as arguments for intervening. The IA provides a stronger basis for intervention through its discussion of the information asymmetry preventing investors from being able to make fully-informed decisions, without such disclosures. In addition, a number of more-general barriers to reporting are given such as climate issues being longer term problems that can be deferred in the eyes of business in pursuit of short-term gain and ‘first mover’ disadvantage. However, for the latter, the IA would benefit from explaining more clearly how this compares to the potential first mover advantage, where businesses may receive a boost due to improved transparency.

### Options

The Department has used recent consultation to help shape the options that have been included in the IA, as well as to identify the preferred one. The IA clarifies how the proposals align with other policy interventions, highlighting how those discussed in this IA differ and are necessary to achieve the desired policy objectives.

The IA includes three legislative options for consideration. All of which have a baseline requirement to report; however two of the options look at mandatory scenario analysis. There is no non-regulatory option included for consideration. While the discussion in the IA (paragraph 38), covering the ‘Do-nothing’ option, explains why inaction is not suitable, it does not explain sufficiently why a non-regulatory option would not be effective in achieving the policy objectives. Earlier in the IA (paragraph 17), there is discussion of why voluntary action is unlikely to be sufficient. The IA would be improved through a clearer communication of the shortcomings of a non-regulatory option and building upon this earlier argument.

# Cost-benefit analysis

### Evidence

As noted explicitly in Section 4 of the IA, the Department, has made extensive use of consultation to inform the proposals and to refine both the evidence base and resulting analysis.

The IA uses new research and evidence from stakeholders, to update the baseline and counterfactual from the consultation stage IA. In particular, the understanding of the current level, and quality, of climate-related reporting of firms has been strengthened. Similarly, the Department has refined the number of businesses falling within scope of the proposals, both in terms of parent group and subsidiaries, as a result of this improved evidence base.

**Methodology**
The IA presents and explains clearly, the calculations that have been undertaken to monetise the costs of the proposals.

**Uncertainty, risks and assumptions**
The IA sets out clearly the full list of key assumptions underpinning the analysis, highlighting where updates and amendments have been made post-consultation.

The IA includes a section on sensitivity analysis, which examines the effect of different baseline scenarios and the number of companies which may already be captured by current Financial Conduct Authority rules, on the EANDCB. The RPC welcomes this analysis, which illustrates the potential change in the scale of the impacts resulting from the two additional pieces of analysis, while also acknowledging the uncertainty around the extent of both.

The IA discusses (paragraph 129) the unintended impacts of the proposals. The IA would benefit from presenting these alongside the main impacts section, to allow for all the potential impacts to be considered altogether.

# Wider impacts

**Innovation**
The IA does not include any clear discussion of the potential impact on innovation within industry, as a result of mandating disclosures being made public. The IA would be improved through considering whether requiring businesses to report publicly on their climate-related aspects of the business operations may have any impact on their innovative activity, and the innovative capacity of industry in general.

**Competition**
The IA discusses the likely expected impact of the proposals on competition, stating that none is expected. However, the IA would be improved through discussing whether some businesses may stand to benefit from already being aligned better with the reporting standard, which will be outlined in the supporting guidance and as a result have an advantage over their competitors.

**Trade**

The IA includes a short paragraph explaining that, while there is an expectation of there being some impact on trade and investment as a result of the proposed measures, it does not estimate said impact. While the RPC acknowledges this degree of uncertainty, the IA would be improved through the inclusion of some qualitative discussion of the impacts that the Department anticipates occurring.

# Monitoring and evaluation plan

The RPC welcomes the Department's commitment to undertake a PIR for this policy. While this is still at an early development stage, the IA goes into significant detail on the intent and likely direction of monitoring and evaluation that it wishes to undertake. The Department has proposed a two-phase approach to evaluation and has provided an initial timeline for the completion of this work.

The IA includes an extensive list of questions relating to the administering and evaluating the policy. The IA could be improved through the inclusion of a theory of change, where the Department might seek to illustrate how the policy proposals will feed through and deliver the desired objectives. While also helping to identify the key metrics that would indicate the success of the policy. The inclusion of primary and secondary targets, in paragraphs 165 and 166 respectively, suggests that the development of a theory of change is underway, however this is still to be completed and refined.

**Regulatory Policy Committee**

For further information, please contact regulatoryenquiries@rpc.gov.uk. Follow us on Twitter @RPC_Gov_UK, LinkedIn or consult our website www.gov.uk/rpc.