Sustainability Disclosure Requirements (SDR)

Lead department	HM Treasury
Summary of proposal	The government are looking to introduce powers and regulations to place requirements upon businesses to make sustainability-related disclosures building on the implementation of the Taskforce for Climate-Related Financial Disclosure (TCFD) recommendations and proposed international standards
Submission type	Impact assessment (IA) – 25 April 2022
Legislation type	Primary legislation
Implementation date	TBC
Policy stage	Final
RPC reference	RPC-HMT-5192(1)
Opinion type	Formal
Date of issue	16 June 2022

RPC opinion

Rating[1]	**RPC opinion**
Fit for purpose	The department provides a good indicative assessment of the likely impacts of the policy, including future secondary legislation, in line with scenario 2 of RPC primary legislation guidance[2]. In addition, the department notes the current disclosure and reporting requirements that business may face, considering where overlaps in impacts exist. The IA identifies the Small and Micro Businesses (SMBs) that would be directly impacted by potential future secondary legislation and provides an appropriate justification for not including an SMB exemption. The indicative analysis draws upon related policies introduced but would benefit from improved clarity over what the costs represent. The investment and environmental impacts are sufficiently considered; however, the IA has not included an appropriate level of discussion of the competition or innovation impacts. While the department commit to undertaking a post implementation review (PIR), there is no discussion of the potential monitoring

[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. RPC ratings are fit for purpose or not fit for purpose.
[2] https://www.gov.uk/government/publications/rpc-case-histories-primary-legislation-ias-august-2019

	and evaluation (M&E) that may be undertaken to support this.

Business impact target assessment

	Department assessment	RPC validated
Classification	Qualifying regulatory provision	Qualifying regulatory provision
Equivalent annual net direct cost to business (EANDCB)	n/a	n/a Further IAs to be submitted at secondary legislation stages for validation of EANDCB figures
Business impact target (BIT) score	n/a	n/a
Business net present value	n/a	
Overall net present value	n/a	

RPC summary

Category	Quality[3]	RPC comments
EANDCB	Green	The department does not present an EANDCB for validation at this stage, instead providing an indicative assessment of the potential future costs. The IA covers a good range of impacts, clearly identifying the potential scope of businesses affected and the likely costs they would face. It does well to acknowledge likely overlaps with current regulatory requirements and the effect this would have on future costs. The RPC expects to assess further IAs at secondary legislation stage in order to validate the EANDCB.
Small and micro business assessment (SaMBA)	Green	The IA identifies SMBs that are likely to be in scope of the proposed requirements and it explains why these businesses cannot be granted an exemption. It would benefit from considering impacts that may specifically affect SMBs, as well as considering the impact upon SMBs who are subsidiaries of larger in scope businesses.
Rationale and options	**Good**	The department identifies a series of market failures, including information failures and economic inefficiency, to support the rationale for intervention. The IA clearly sets out the current voluntary initiatives and, in addition to the preferred option to regulate, discusses a further non-regulatory alternative.
Cost-benefit analysis	**Satisfactory**	The department provide indicative figures at this time to support the qualitative assessment of potential future costs. The IA would be improved by clearer explanation of some of the sources used to inform the indicative costs.
Wider impacts	**Weak**	The IA considers investment and the environmental impacts of the policy throughout the IA, however given the focus of the Bill, these impacts should be addressed in specific sections considering the overall impact. Furthermore, the IA needs to fully consider the competition impacts and the impacts to the growth of and investment, innovative industries.
Monitoring and evaluation plan	**Weak**	The department commits to undertaking a PIR, with M&E being carried out as appropriate for individual measures. However, the IA does not provide any detail on what will be evaluated or how this will be done.

[3] The RPC quality ratings are used to indicate the quality and robustness of the evidence used to support different analytical areas. Please find the definitions of the RPC quality ratings here.

Summary of proposal

There are increasing concerns that the lack of standards and clear, as well as reliable, information on investments' sustainability characteristics, is making it difficult for investors to make informed decisions about how to both best use their capital and support green initiatives. The government have previously set out its desire for green finance to be a fundamental part of the strategy to achieve Net Zero. Disclosure requirements, building on the work by the TCFD, are seen as an important tool for raising the reporting standards and improving information provision. The department has considered the following options:

- Option 0: Do-nothing;
- Option 1: Voluntary disclosure with guidance (non-regulatory); and
- Option 2: Mandatory disclosures for businesses in scope, in line with TCFD recommendations.

The scope of businesses which will fall under the requirements of option 2 is still to be decided through future secondary legislation, however the department has included consideration of two potential sub-options[4] as part of the IA, to assist with providing an indication of impacts.

The IA expects the main costs of future secondary legislation to be initial familiarisation costs, the costs of financial disclosure reporting (varying by the group required to do so) and costs to the regulators. Meanwhile the expected benefits of the policy are identified as benefits to wider business from improved information and the resulting more efficient capital allocation, and the benefits to society from the move towards greener financial investments. Due to the degree of uncertainty, the department does not include an indicative estimate, such as an EANDCB or NPV, of the total impact of the policy.

The RPC looks forward to seeing subsequent IAs from a range of departments and regulators at secondary legislation stage.

EANDCB

Identification of impacts

The IA identifies a range of impacts, for the policy across both primary and secondary legislation. The department has not sought to quantify the impact of the policy at this stage, but has provided a qualitative assessment of the impacts, supported by an appropriate degree of indicative analysis, in line with scenario 2 of RPC primary legislation guidance[5]. The department has committed to developing further assessments, as appropriate for future secondary legislation, where relevant

[4] Option (2a): All current UK Public Interest Entities (PIEs). This option involves establishing a framework to adopt the ISDS and mandate their use for all current UK PIEs.
Option (2b) (preferred): All UK entities in scope of current UK TCFD ("TCFD scope). This option would mandate the use of UK International Sustainability Disclosure Standards to all UK entities currently reporting under TCFD scope.

[5] https://www.gov.uk/government/publications/rpc-case-histories-primary-legislation-ias-august-2019

EANDCB figures will be put forth for validation. The IA identifies likely impacts across a range of different groups, both those who may be in scope of the regulations (i.e., businesses) as well as regulators.

Counterfactual/baseline

The department clearly acknowledges previous legislation introduced, that places similar requirements upon some businesses that may be in scope. In the discussion of impacts, the department correctly identifies the potential overlap for businesses in reporting against existing and new policies, which would therefore lessen the potential impact of future secondary legislation. In addition, the department discusses what current policies and other initiatives are in place, to improve the level and quality of financial reporting by industry but have so far not been successful in driving the desired standard.

SaMBA

Scope

The department identifies that under one of the potential options, that could be implemented through secondary legislation, a small group of SMBs would be in scope of the disclosure requirements. The IA would be improved by discussing the specific costs these businesses would face and how they may differ from those faced by larger businesses, in particular whether costs such as that for data collection and processing would be greater.

In addition, the IA would be improved by considering the extent to which SMBs that are subsidiaries within a wider business and whose parent company is in scope will be impacted, as requirements placed upon their parent organisation may require them to act.

Exemption and mitigation

The department provides a clear explanation of why there should not be an exemption for SMBs, citing that it would not be appropriate to exempt those who do fall under the scope of the policy being proposed, due to the significant assets that they handle. The IA would be improved by expanding this discussion, to explain clearly why in addition to not including an exemption for SMBs from the policy, it is also appropriate not to offer mitigation to SMBs impacted. The RPC advises that this aspect is addressed within future SaMBAs in IAs developed to support secondary legislation.

Rationale and options

Rationale

The IA identifies a set of market failures, to support the rationale for intervention. These are principally information failures, the inefficient allocation of resources (i.e., capital) and more generally the negative externalities associated with carbon intensive investments. Furthermore, the department has established a clear set of policy objectives, such as combatting greenwashing, ensuring the provision of decision-useful information for investors and to support market demand and innovation for investment in responsible and sustainable investment strategies.

Options

The department discusses three options in the IA, including a non-regulatory option and the description of the do-nothing option which clearly establishes the current voluntary initiatives in place to improve reporting. The IA would be improved by considering whether the actions described in option 1 (e.g., voluntary disclosure with guidance) could be implemented in addition to that described under option 2 (e.g., mandatory disclosure), to ensure the most effective compliance with the new requirements.

Cost-benefit analysis

Evidence and data

The department includes indicative analysis to support the qualitative discussion of the expected impacts at this stage. The IA draws heavily from the previous IA undertaken by the Department for Business, Energy and Industrial Strategy (BEIS), on which the RPC previously opined[6], covering the policy mandating climate-related financial disclosures by publicly quoted companies, large private companies and limited liability partnerships, as well as a similar assessment undertaken by the Financial Conduct Authority (FCA) for asset managers and owners, and an assessment by the Department for Work and Pensions (DWP) for occupational pension schemes. The IA would be improved by more clearly explaining the similarities between the policies in question, the businesses that are in scope and the specific functions that are covered by the costs drawn from these external assessments of TCFD reporting.

Assumptions, risk and sensitivity

The department notes a series of assumptions in its discussion of impacts and the indicative analysis to support it. For example, the IA assumes that the SDR changes are likely to be marginal. However, given the proposal appears to be trying to drive a common approach, the IA would benefit from supportive evidence on the potential magnitude of the impact on businesses of obtaining and reporting the data.

For any further assessments, seeking to fully quantify the impact of the policy, the department should ensure that all assumptions are supported by robust and appropriate evidence.

The IA makes use of different scenarios (e.g., 20, 50 and 100 per cent deflators applied to FCA IA costs of the TCFD) to account for the uncertainty. The IA would benefit from explaining the appropriateness of the scenarios used, what has

[6] https://www.gov.uk/government/publications/the-limited-liability-partnerships-climate-related-financial-disclosure-regulations-2022

informed their inclusion in the analysis and how reflective they are of the potential range in costs.

The IA would be further improved, if it discussed the expected implementation timeframes for the various measures to be introduced later by BEIS, FCA and DWP, and whether the costs faced by business may vary depending on which measures were to be introduced first.

Wider impacts

Innovation

The IA briefly mentions innovation, however, does not discuss the impacts on innovation in any detail. It needs to consider the impacts to innovation of the policy, in particular whether the improved information provided to investors, will better enable those in innovative and novel sectors to secure funding and growth.

Competition

While the IA does briefly allude to the policy likely supporting fair competition between firms, it needs to have included discussion of the competition impacts of the new requirements in more detail. In particular, it would benefit from considering the impacts to markets/firms who currently make disclosures to a higher standard, potentially as a means to set themselves apart from competitors.

Trade and investment

The department considers the impact to investment implicitly through the design of the policy. The desire to ensure that investors have accurate information from which to make decisions, and the impact of this, is discussed. The IA would be improved through greater consideration and discussion of the impact of ensuring alignment in disclosure requirements internationally and the impacts to inward foreign investment of both having, and not having, alignment.

Monitoring and evaluation plan

The department commits to undertaking a PIR for the policy. In addition, the IA states that relevant departments and regulators – e.g., BEIS, the Department for Work and Pensions (DWP), and the FCA - will conduct M&E for the respective measures under their remit. The IA does not however, provide any details of what M&E activities will be undertaken. It needs to include discussion and consideration of how the department will determine if the policy has been successful (linking back to the policy objectives as appropriate), as well as what evidence/data needs to be collected to support this determination of success.

Regulatory Policy Committee

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