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The UK Sustainability Technical Advisory Committee

By email to UKSustainabilityTAC@frc.org.uk

**Date:** 18 October 2023

Dear Sir or Madam,

**Re: Railpen's response to the Financial Reporting Council's Call for Evidence on the UK endorsement of IFRS S1 and IFRS S2**

Railpen is an investment manager and fiduciary adviser to one of the UK's largest pension funds. We, and our ultimate client, have an inherently long-term investment horizon. We strongly believe that our members' financial best interests are connected to the ways in which companies attend to long-term sustainability risks and opportunities. It is vital therefore that we, as investors in companies, can avail ourselves of timely, reliable, comparable, and decision-useful information on the ways in which corporates manage sustainability-related business risks. At a more general level, capital market participants require access to information that facilitates price discovery and efficient capital allocation. As a result, we continue to offer our strong support to the work of the ISSB including the recent official publication of IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures*. We also place on record our appreciation for the thoroughness of ISSB's due process and the level of stakeholder outreach throughout.

We acknowledge the decisions that were made in response to consultation feedback received on exposure drafts S1 and S2. In our view, as investors and users of sustainability-related disclosures, the priority for ISSB should be to ensure the integrity of the global baseline is retained. The global comparability – not just of the information presented, but the basis of preparation, frequency of reporting, and other 'ground rules' – is essential to the use-case of the disclosure frameworks from an investor's standpoint. The attainment of an endorsement from the International Organization of Securities Commissions (IOSCO) was an important step for achieving a global baseline; attention needs to focus on ensuring consistency across regional jurisdictions/ markets (and preventing some markets opting out or pursuing divergent approaches). We are proud that the UK, our home market, was among the first jurisdictions to commit to assessing the suitability of the ISSB standards with a view to endorsement.

Further, we believe in the importance of the 'interoperability' of ISSB frameworks with other complementary global frameworks. We welcome the work undertaken to date to simplify, and limit duplication of, disclosure requests of corporates and investors. A 'building blocks' approach is likely to be more efficient for preparers and users and increases the likelihood of the global uptake of ISSB frameworks.

Notwithstanding the benefits of simplicity, investors will only find the global baseline useful to the extent that it provides for insights relevant to their investment decision-making. The relevance of sustainability-related financial information depends crucially on the sector in which a company operates. The global baseline must have sector-specific disclosure requirements for the information to be of use to investors.

We have agreed with the ISSB's approach to deliver the global baseline using a "climate-first but not climate-only" philosophy. Whilst climate change remains the most discussed sustainability-related business risk, there are many other non-climate sustainability-related value drivers that investors need to understand in order to make informed decisions for their beneficiaries.

In relation to Q1, our understanding (based on our dialogue with companies) is that the interpretation of IFRS S1 and S2 is clear. We certainly believe so as investors. The crucial improvement in a UK context is that adoption of S1 and S2 would allow the UK to contribute to a *global* baseline of sustainability-related financial data that has not hitherto been made available to investors. A global baseline facilitates comparability across any company in a global portfolio. We can say from experience that use of SASB standards, and in future S1 and S2, is a vital input into our investment process. Consideration of financially material sustainability risks is a basic element of our fiduciary duty.

In relation to Q3, companies should identify material sustainability risks and opportunities themselves, and this might mean going beyond the S1 and S2 disclosure requirements. We use SASB standards as a highly useful starting point, but we supplement the standards where necessary to get as complete a picture as feasible of relevant sustainability-related value drivers.

In relation to Q5, a major drawback of the current state of sustainability-related financial disclosures is the lag between financial disclosures and the sustainability related disclosures. Given the threshold of financial materiality proposed, a board should be preparing this information side-by-side with other elements of the strategic report, not considering it as a separate exercise. Investors wish to understand the financial sensitivities of sustainability risks, and they take comfort when a company's board demonstrates an integrated awareness of these kinds of risks.

In relation to Q8, industry-based disclosures are an essential feature of sustainability-related financial information. One-size-fits-all sustainability-related information will not be financially material and will therefore be ignored by investors. We are aware that sector-specificity is not a desirable characteristic from an accountant's or an auditor's vantage point. If, however, these disclosures are to serve investors, industry-based disclosures are a necessity.

In relation to Q10, we would recommend the IFRS' own "Effects Analysis" for a comprehensive answer to this question[1].

We hope that this response has been of interest. We would be happy to discuss further any of the issues raised above.

Yours sincerely,

**Michael Marshall**
Head of Investment Risk & Sustainable Ownership
Railpen

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[1] Available here: https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/effects-analysis.pdf

## About Railpen

Railpen is the trading name of Railway Pension Investments Limited, which is authorised and regulated by the Financial Conduct Authority (FCA). Railpen acts as the investment manager for the railways pension schemes and is responsible for the management of around c. £37 billion of assets on behalf of over 350,000 members. We also operate as an authorised master trust in respect of our Industry-Wide Defined Contribution arrangement that operates for the benefit of members with c. £1.7bn of DC funds included in our total assets under management.

'Sustainable Ownership' is Railpen's approach to incorporating sustainability considerations into the investments it manages on behalf of members. Railpen's work is enabled by the Trustee's related investment belief: "Incorporating and acting upon climate risk and other environmental, social and governance factors are significant drivers of investment outcomes and part of our fiduciary duty".

As one of the largest UK pension funds, and one of the few remaining occupational pension schemes with open, immature, Defined Benefit (DB) sections, we recognise the impact of corporate sustainability on our long-term investments. We have been, and remain, enthusiastic champions for improvements to the quality and completeness of corporate sustainability disclosure, as reflected in our levels of policy engagement and company stewardship focussed on this topic.

You can find out more about our work, including our Net Zero Plan, Stewardship Report and Sustainable Ownership Review on our website.

# Appendix: Index of questions

**Question 1 — Overall views on the standards**

- How easy or difficult is it to interpret the requirements described in IFRS S1 and IFRS S2?
- To what extent will the requirements in the standards improve upon existing reporting in the context of the UK?
- To what extent do you think that application of the standards in the UK is technically feasible?
- How, if at all, might the information disclosed in accordance with IFRS S1 and IFRS S2 be used by investors for their decision-making, and companies for the management of the business?

**Question 2 — Identifying sustainability-related risks and opportunities**

- What challenges, if any, are there for UK companies in identifying and disclosing all sustainability-related risks and opportunities based upon the requirements? Please explain your response.
- Have you used, or do you plan to use, the sources of guidance in IFRS S1 paragraph 54–55 and the disclosure topics in IFRS S2 paragraph 12 to identify sustainability-related and climate-related risks and opportunities? Do you have any comments on their use?

**Question 3 — Application of materiality**

- Is it clear how the concept of materiality (IFRS S1 paragraphs 17–19) applies to the identification and disclosure of sustainability-related risks and opportunities? Please explain your response.
- How do investors identify sustainability-related information that is material in a company's annual report?

**Question 4 — Reporting approach**

- What, if any, are the challenges in preparing sustainability-related disclosures at the same entity level used in the preparation of financial statements (e.g., consolidated reporting or entity-level reporting)? Please explain your response.
- Is there sufficient guidance on how to identify the value chain and on how to prepare and present information about sustainability-related risks and opportunities in the value chain? If not, what would you need to be able to comply with this requirement?

**Question 5 — Timing and location**

- What are your estimates of the benefits or costs in relation to reporting sustainability-related information at the same time and in the same location as general purpose financial reports for companies in the UK?
- If UK companies were to include this information in the Strategic Report, how will they be able to ensure that this information is presented in a manner such that it is clearly identifiable and is not obscured by other information (IFRS S1 paragraph 62)?

**Question 6 — Judgements, uncertainties and errors**

- How clear, if at all, are the requirements in IFRS S1 paragraphs 74–86 regarding judgements, uncertainties and errors? How easy or difficult is it to distinguish between a change of estimate and an error? Please explain your response.

- What, if any, further considerations are there in respect of disclosing revised comparative information when there are changes in estimates?

**Question 7 — Financial impact and connectivity**

- How easy or difficult is it to interpret the requirements for preparing and disclosing information about the current and anticipated effects of sustainability-related information on the financial position, financial performance and cash flows? Please explain your response.
- What, if any, are the challenges in preparing disclosures that connect sustainability-related information to the financial statements?

**Question 8 — Industry-based requirements**

- What, if any, are your estimates of the benefits and/or costs in preparing industry-based disclosures?
- Should the standards stipulate which guidance and industry-based topics and metrics a company should disclose, and why?
- What, if any, are the other sources of guidance that are currently used by UK companies?

**Question 9 — Cross-industry metrics (IFRS S2 only)**

- Are the requirements for greenhouse gas reporting, including on financed emissions, technically and practically feasible? If not, please explain the reasons for this. You might want to consider resource, infrastructure, measurement methods (including the GHG Protocol Corporate Standard) or other challenges.
- What, if any, are the challenges in preparing and disclosing information about the cross-industry metrics other than greenhouse gas emissions (IFRS S2 paragraph 29(b)–(g))?

**Question 10 — Costs and benefits**

- What are the anticipated benefits of preparing and disclosing information required by IFRS S1 and IFRS S2 (for both companies and investors), and which elements of the standards will provide the greatest benefits?
- What are the anticipated drivers of costs when preparing and disclosing information required by IFRS S1 and IFRS S2?
- What is the current process used by preparers to gather the relevant sustainability-related information required for reporting purposes? Please include information on the sources (where data is gathered), the frequency and associated costs.
- Please outline the additional steps your company would need to undergo to comply with the requirements of IFRS S1 and IFRS S2? Please consider staff, time, production, IT and any other costs associated with compliance. Which of these steps is the most costly/challenging steps, and why?
- How far do you agree or disagree that the benefits of disclosure will outweigh the costs of reporting over time?

**Question 11 — Application of the requirements**

- How might the proportionality provisions* ease reporting burdens or reduce challenges within reporting, if at all?
- Do the reliefs provided in IFRS S1 and IFRS S2 give appropriate transitional relief as preparers develop their reporting in this area? Please explain your answer.

- Are there any further anticipated challenges in the application of IFRS S1 and IFRS S2 that are not considered or addressed in the standards and guidance?

**Question 12 — Any further comments**

- Please provide any other comments on the requirements in IFRS S1 and IFRS S2 and their potential application in the UK.