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Lessons in sustainability reporting: The FRC on CFDs

01 April 2025 Jeremy Irving

First published on Thomson Reuters.

In January 2025 the Financial Reporting Council ('FRC') published its Thematic Review of Climate-related ('C-R') Financial Disclosures ('CFDs') by AIM and Large Private Companies the ('Report').

Key findings as to *"… the quality of CFD reporting [which] varied across our selection …"*, and, more importantly, as to the levels of compliance with statutory requirements as to CFDs included the following.

- In relation to the obligation to provide an analysis of the resilience of the company's business model and strategy considering different C-R scenarios, *"several companies failed to provide any analysis, with others providing disclosures that were not sufficiently company specific …"*
- *"Only half of the companies presented all [the] information [in relation to [C-R] targets, and the assessment of progress against these targets using key performance indicators ("KPIs")] …"*
- *"… some companies failed to explain the way in which [C-R] risks and opportunities were identified … opportunities were not always identified … [and] the timeframes over which the risks and opportunities were assessed were not always described …"*

These findings are important for entities subject to the CFD provisions of the Companies Act 2006 ('CA' – see section 2 below) but also for entities seeking to make broader sustainability-related disclosures, especially as further required by the CA, and/or the Financial Conduct Authority's ('FCA') rules in chapter 2 of the Environmental Social Governance ('ESG') Sourcebook (see section 4 below).

2. To whom is the report immediately relevant?

CA s414CA sets out obligations as to CFDs. These obligations apply to various entities with different attributes, provided the entity (or, where the entity is a parent company, the group for which it is parent) has over 500 employees.

Financial services ('FS') businesses could be subject to the above obligations on the basis that they are authorised under the Financial Services and Markets Act 2000 ('FSMA') with:

- primary permissions to accept deposits (ie a 'banking company', but not a business where such permission is subordinate to a different regulated activity under FSMA) or
- permissions to effect and carry out contracts of insurance (including 'insurance companies' and Lloyd's managing agents).

Other FS firms could be subject to s414CA because, in short,

- their shares or bonds are 'traded' on a Regulated Market (plus AIM) or
- their annual turnover is £500m (with the 'parent proviso' as per the employee threshold above).

3. The report's basis, parameters and key contents

Basis and parameters

The FRC's interest in CFDs derives from its statutory role under CA s456 as to enforcing the production of compliant strategic reports (which are required under s414A).

The Report is based on a sample of 20 UK companies with reports for *"year-ends … between August and December 2023 …"* and either

- *"… AIM [traded] or*
- *private companies [which had a] turnover of more than £500 million."*

The selected companies included:

- 1 which was described by the FRC as *"Financial"*,
- 10 businesses in the 'consumer' or 'tech' categories, and
- 9 in 'industrials', 'materials' and 'utilities'.

Companies were only named where their disclosures exemplified 'good practice'. Those named do not appear to be 'Financial' firms, in that they do not appear as active on the FCA's Financial Services Register (although some used to be). Nevertheless, as explained below, FS firms can gain much from findings as to other sectors.

The group dimension

Given the corporate holding structures for FS firms, and their cross-border operations and ownership, the Report's points about the effect of group and international issues for CFDs are especially significant. For the FRC:

- *"Good disclosures were provided from the perspective of the group headed by an intermediate UK parent. These disclosures explained concisely how the UK group's [C-R] governance and risk management arrangements interacted with those of the wider group …";*
- conversely, *"An omission of [a] required disclosure or other issue [which] companies should avoid in their [strategic] reports …"* included:
  - *"One company's [C-R] disclosures [which] were taken from those provided by its overseas parent with limited tailoring for its own circumstances … [eg] the KPIs disclosed were those of the overseas parent …";*
  - also, *"Several of the companies with overseas operations did not explain whether their GHG [greenhouse gas] emission reduction targets and associated KPIs included GHG emissions from their non-UK operations …"*

Linked to the issues on the substance of disclosures from international groups is the issue of the documentary location of those disclosures. In short, a strategic report must contain the relevant CFDs, save where those CFDs are contained in a UK parent's consolidated report. However, the FRC found: *"Five … companies did not include sufficient disclosures in the … [strategic] report … to meet all the [CA's] requirements …*

- *For two companies, at least one further requirement would have been met had some of the information presented in [their] separate ESG reports been included in … [their strategic] report …*
- *One parent company did not provide all the CFD information required … [but] cross-referred to … a subsidiary's [Task Force on [C-R] Financial Disclosure ('TCFD')] statement. This approach is insufficient …"*

4. The report's wider relevance

The Climate-related Financial Disclosures and other sustainability reporting

The Report highlights the similarities and differences with TCFD-based reporting, such as required via ESG 2 - FCA Handbook. One can perceive the FRC's view that the key difference (aside from a TCFD report being compliant even if not in a company's annual report) is that the 'comply or explain' principle in TCFD reporting (see eg ESG 2.2.4 R as to the non-use of C-R targets) is less extensive – perhaps even less rigorous – than the CA's requirement (s414CB(4A, B)) for a 'clear and reasoned explanation' in the strategic report why disclosures are not needed in respect of:

- impacts from C-R risks and opportunities,
- a company's resilience (in the light of different climate scenarios), and
- its C-R targets and KPIs.

CFDs require a more sophisticated approach than disclosures under CA s414CB(1) as to:

- 'environmental',
- 'employees',

- ‘social matters’,
- ‘human rights’ and
- ‘anti-corruption / bribery’.

The above require disclosures as to:

- ‘risks’ (but not ‘opportunities’),
- ‘business model’ (but not ‘strategy’), and
- ‘KPIs’ (but not ‘targets’),

nor as to a company’s resilience in the light of different scenarios.

Nevertheless, the Report is valuable for all forms of sustainability reporting because of:

- its guidance on responding precisely to the terms and parameters of statutory requirements, and
- approaching the substance of such reporting with specificity, especially as to matters of:
- time
- geography (and the overlap with legal jurisdiction),
- corporate entities, and
- business model attributes (eg customers, suppliers and physical assets).

The international context

Given current issues as to divergence between sustainability reporting laws as between, say, the UK and EU on the one hand, and the US (or various of its States) on the other – especially where such divergence results in an unavailability of data, or a discouragement or prohibition of engagement in, or public disclosure on, ESG issues – complying with the CA’s CFD requirements seems likely to become more challenging for UK subsidiaries within international groups.

These challenges may only increase as demand from UK regulators increases for more precise and thorough compliance with such requirements, and the Report is a further example of such demand and increase (eg see previously the FRC’s 2023 Thematic review of [C-R] metrics and targets and the joint FRC and FCA work from 2022 on TCFD disclosures and climate in the financial statements).

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