Advocates for International Development

Lawyers Eradicating Poverty

ESG REPORTING ON THE LONDON STOCK EXCHANGE

NICK O'DONNELL
JOHANNES POON
ISABEL CARTY
ANNA SOKOLOVSKAYA

BAKER & MCKENZIE LLP

Type: Legal Guide
Published: June 2013
Last Updated: June 2013
Keywords: LSE; London Stock Exchange; ESG; Environment;

This document provides general information and comments on the subject matter covered and is not a comprehensive treatment of the subject. It is not intended to provide legal advice. With respect to the subject matter, viewers should not rely on this information, but seek specific legal advice before taking any legal action

Any opinions expressed in this document are those of the author and do not necessarily reflect the position and/or opinions of A4ID

© Advocates for International Development 2013

Introduction

1.1 Purpose of the guide

The purpose of this guide is to provide an overview of the key reporting requirements in connection with environmental, social and governance (ESG) issues that are applicable to public companies whose securities are traded on the LSE. This guide does not aim to be comprehensive. Further specialist advice may be required to determine if mandatory disclosure requirements are triggered in specific scenarios. Similarly, voluntary reporting requirements mentioned in this guide represent only a few of the most prominent examples. The links to third-party websites contained in this document may not continue to remain active, but are correct as at the date of this guide.

1.2 Background information about the London Stock Exchange

The London Stock Exchange ("LSE") is one of the world's oldest and largest stock exchanges. The Main Market is the LSE's principal market for listed companies from the UK and overseas. The LSE also operates and regulates a more "junior" market, AIM, to accommodate the needs of smaller and developing companies.

The LSE's listing regime is comprised of three segments - standard listing, premium listing and the High Growth Segment. Broadly speaking, issuers with a standard listing have to comply only with EU directive minimum requirements for listing, whereas issuers with a premium listing (which is only available for equity shares issued by commercial companies and certain investment entities) must additionally comply with so-called "super equivalent" provisions set in the UK by the Financial Conduct Authority ("FCA") (including enhanced corporate governance rules) which apply over and above EU directive minimum requirements.

The mandatory reporting obligations (including those that relate to ESG matters) applicable to premium- and standard-listed companies can be found in the FCA's set of rules called the "FCA Handbook". The High Growth Segment was launched in March 2013 and is intended to allow fast growing companies which intend to seek a premium listing in the future to be admitted to a new segment of the Main Market. Companies in the High Growth Segment must comply with certain parts of the FCA Handbook as well as the High Growth Segment Rulebook. As this new segment is not yet an established part of the UK listing landscape, this guide does not discuss it further.

Companies quoted on AIM are generally not subject to the FCA Handbook (but various provisions in the Disclosure and Transparency Rules would still apply), and would particularly need to ensure compliance with the AIM Rules for Companies published by the LSE.

2. What are the mandatory reporting requirements for public companies whose securities are traded on the LSE regarding their actual or potential ESG risks or impacts?

Companies whose securities are traded on the LSE include public companies incorporated in the UK (that comprise companies incorporated in England and Wales, Scotland and Northern Ireland) and public companies incorporated overseas. UK incorporated companies whose securities are traded on the LSE are effectively subject to two sets of mandatory reporting requirements: (i) those emanating from general English company law which are only applicable to companies incorporated in the UK, e.g. the Companies Act 2006 ("CA 2006") and (ii) those that are specific to the company's status on the LSE. In some respects the two sets of requirements overlap.

Three factors will effectively determine the extent of mandatory reporting obligations, including ESG reporting, imposed on a company whose securities are traded on the LSE: (i) whether a particular company is incorporated in the UK or overseas; (ii) whether the company is listed on the Main Market or quoted on AIM, and (iii) in case of companies listed on the Main Market, whether the company has a premium or standard listing.

2.1 Premium-listed companies

(a) CA 2006: directors' duties and narrative reporting requirements (UK companies)

In relation to companies incorporated in the UK, CA 2006 imposes a duty on directors to promote the success of the company and in doing so to have regard to the company's impact on the environment, amongst other things. Directors are required to prepare an annual directors' report containing a business review that demonstrates how the directors have performed this duty (sections 415 and 417 CA 2006).

The business review should contain a fair review of the company's business and a description of the principal risks and uncertainties facing the company. In addition, companies listed on the Main Market of the LSE (but not companies admitted to AIM) should, to the extent necessary for an understanding of the development, performance or position of the company's business, include in their business review information about (i) environmental matters (including the impact of the company's business on the environment), (ii) the company's employees, and (iii) social and community issues. The business review of a Main Market listed company would also include information about the company's policies in the above three areas and the effectiveness of those policies. Further, if the review does not contain information of each prescribed kind, it would need to state which of those kinds of information it does not contain.

To the extent necessary to gain an understanding of the development, performance or position of the company's business, the business

review would also include an analysis of the business using various key performance indicators ("KPIs"), including, where appropriate, those relating to environmental and employee matters.

There are currently proposals to replace the requirement for a business review with a new requirement to produce a standalone strategic report. The strategic report will contain broadly similar content to that currently required in the business review (including an analysis of the business in relation to environmental and employee matters). The new regulations are expected to come into force around October 2013.

As regards reporting on environmental issues in particular, in 2006 the UK's Department for Food, Environment and Rural Affairs ("DEFRA") issued a paper called "Environmental Key Performance Indicators: Reporting Guidelines for UK Business". The guidelines intend to help companies to effectively measure, report on and compare their environmental progress. The guidelines set out 22 environmental KPIs and contain a chart helping companies to identify the direct and indirect KPIs most relevant to their industry sector. The KPIs include the following: (i) emissions to air (greenhouse gases; acid rain, eutrophication and smog precursors; dust and particles; ozone depleting substances; volatile organic compounds; metal emissions to air); (ii) emissions to water (nutrients and organic pollutants; metal emissions to water); (iii) emissions to land (pesticides and fertilisers; metal emissions to land; acids and organic pollutants; waste: landfill, incinerated and recycled; radioactive waste); (iv) resource use (water use and abstraction; natural gas; oil; metals; coal; minerals; aggregates; forestry; agriculture).

DEFRA's guidelines are voluntary in nature, but are intended to be relevant to both mandatory and voluntary environmental reporting. In July 2012, DEFRA published a consultation paper in relation to revising the current set of guidelines. DEFRA is expected to publish a revised set of guidelines this year with a new section that will give guidance on the mandatory reporting of greenhouse gas emissions for UK-incorporated companies listed on the Main Market. It is anticipated that these proposed mandatory reporting requirements will be introduced in October 2013.

(b) FCA's Disclosure and Transparency Rules: Periodic Reporting Requirements and Disclosure of Inside Information

Both premium and standard-listed companies are required to make public their annual financial reports which should include, among other things, a management report containing a fair review of the company's business.

To the extent necessary for an understanding of the development, performance or position of the company's business, the "fair review" included in the management report should provide an analysis of the

company's performance using various KPIs, including information relating to environmental matters and employee matters.

In addition, the FCA's Disclosure and Transparency Rules also impose requirements on both premium and standard listed companies to notify a regulated information service as soon as possible of any inside information which directly concerns the company. These could include ESG issues that a reasonable investor would use in making his investment decisions and be likely to have a significant effect on the price of the company's shares.

(c) FCA's Listing Rules: disclosure statement in annual financial report

Both premium and standard-listed companies are required to include a corporate governance statement in their directors' reports. Companies with a premium listing on the LSE are also required to produce a statement in their annual reports stating how they have applied the Main Principles of the UK Corporate Governance Code (the "CGC"), a statement as to whether or not they have complied throughout the accounting period with the CGC and to explain and justify any non–compliance.

Please see paragraph 4 of this guide for more information on the requirements to include corporate governance statements in the directors' reports.

2.2 Standard-listed companies

(a) CA 2006: directors' duties and narrative reporting requirements (UK companies)

Companies that are incorporated in the UK need to comply with the narrative reporting requirements set out in the CA 2006 (see paragraph 2.1(a) above).

(b) FCA's Disclosure and Transparency Rules: Periodic Reporting Requirements and Disclosure of Inside Information

Both premium and standard-listed companies would have to disclose ESG issues in their annual financial reports pursuant to the FCA's Disclosure and Transparency Rules where this is necessary for a fair review of the company's business or relates to principal risks, and also notify a regulated information service of ESG issues relating to the company (to the extent these constitute inside information). The requirements for such disclosure are the same as those for premium-listed companies (please see paragraph 2.1(a) above).

(c) FCA's Listing Rules: disclosure statement in annual financial report

Both premium and standard-listed companies are required to include a corporate governance statement in their directors' report.

Please, however, see paragraph 4.2 below for more information on the requirements to include corporate governance statements in the directors' reports.

2.3 AIM

(a) CA 2006: directors' duties and narrative reporting requirements (UK companies)

Companies that are incorporated in the UK and admitted to AIM must comply with the narrative reporting requirements set out in the CA 2006 (please see paragraph 2.1(a) above).

(b) AIM Rules

An AIM company may need to publically disclose without delay ESG issues to the extent these constitute new developments which are not public knowledge concerning a change in its financial condition, sphere of activity, business performance or expectation of its performance which, if made public, would be likely to lead to a substantial movement in the price of its shares.

3. What are the voluntary reporting requirements for public companies whose securities are traded on the LSE regarding their actual or potential ESG risks or impacts?

Notwithstanding their mandatory ESG reporting requirements, companies may voluntarily report on actual or potential ESG risks or impacts. Motivations for doing so can include shareholder and stakeholder demands such as upwards supply chain pressure, ethical considerations or indirect business benefits, such as avoiding reputational issues or gaining brand recognition.

3.1 Premium-listed companies

(a) Environmental

Environmental reporting guidelines are the most detailed and comprehensive of the various available voluntary ESG reporting standards. In addition to the motivations set out above, companies are inclined to make voluntary environmental disclosures in preparation for the advent of increased mandatory environmental reporting. For example, the Climate Change Act 2008 ("CCA 2008"), which requires the UK government to substantially reduce UK greenhouse gas ("GHG") emissions by 2050, provides for future mandatory reporting for UK companies.

Under sections 83-85 and 416(4) CCA 2008, the Secretary of State is to provide guidance on GHG emissions measurements to assist companies in reporting on the matter, review how reporting is facilitating emissions reductions, and either make regulations requiring GHG emissions reporting in directors' reports or, explain to Parliament why this has not been done. DEFRA is

currently reviewing these Greenhouse Gas Emissions (Directors' Reports) Regulations 2013 (the "2013 Regulations") which are expected to come into force in 2013.

Both the 2013 Regulations and the Climate Change Disclosure Standards' Climate Change Reporting Framework Edition 1[1], which provides for climate change reporting within standard financial reports, are based on the GHG Protocol[2]. The Corporate Accounting and Reporting Standards, Project Accounting Protocol and Guidelines, Corporate Value Chain (Scope 3) Accounting and Reporting Standard, and Product Life Cycle Reporting Standard comprise this protocol. These standards go beyond simple emissions reporting by soliciting disclosures relating to entire supply chains, company groups and product life cycles.

The Global Reporting Initiative's Sustainability Reporting Framework and G3 Guidelines[3] set out a standard disclosure and indicator-based reporting framework. Sector-specific frameworks are also available. These standards are subscribed to internationally by over 75% of the Global Fortune 250. Accounting for Sustainability provides a similar practical reporting guide[4].

The Pensions Investment Research Consultants' ("PIRC") UK Shareowner Voting Guidelines[5] recommend use of the Carbon Disclosure Project's framework[6] for environmental reporting, including detailed quantitative environmental data and water use reporting[7]. This project represents over 500 institutional investors' views.

Other voluntary environmental reporting guidelines include the Global Framework for Climate Risk Disclosure[8], the CEO Water Mandate's draft guidelines on water reporting[9] and the Equator Principles[10].

(b) Social

With regards to social reporting, the UK government has developed the Think, Act, Report framework for voluntary disclosures on gender equality[11]. This framework encourages narrative reporting on the relevant company's attitude and activity with regards to gender equality, including publication of staff surveys where applicable. It also advocates for reporting on workforce measures including gender representation as a whole and at different levels

---

[1] http://www.cdsb.net/climate-change-reporting-framework
[2] http://www.ghgprotocol.org/standards
[3] https://www.globalreporting.org/reporting/reporting-framework-overview/Pages/default.aspx
[4] http://www.accountingforsustainability.org/
[5] http://www.pirc.co.uk/publications
[6] http://www.cdsb.net/

[7] http://environment.practicallaw.com/1-501-2747
[8] www.unepfi.org/fileadmin/documents/global_framework.pdf
[9] www.ceowatermandate.org/files/DisclosureGuidelinesFull.pdf
[10] http://www.equator-principles.com/
[11] http://www.homeoffice.gov.uk/publications/equalities/womens-equality/gender-equality-reporting/think-act-report-framework

and positions. Finally, the framework promotes reporting on pay measures such as the general, and full versus part time, gender pay gaps for starting and continuing salaries.

UK companies can also voluntarily subscribe to the internationally applicable International Organisation for Standardisation's Social Accountability 8000 standards and ISO 26000 guidelines12. The first of these standards is auditable and addresses labour and workplace conditions. The second of these standards offers general social responsibility reporting and stakeholder discussion guidance to companies.

(c) Governance

There are a number of voluntary governance reporting standards for UK companies.

Investor guidelines comprise certain of these standards. One prominent example is the Association of British Insurers' Guidelines on Responsible Investment Disclosure (the "ABI Guidelines")13. The ABI Guidelines support narrative reporting which frames ESG risks in the context of the company's overall risks, describes how the board will act to counter these risks, and looks to the future. They also suggest that companies disclose various ESG measures and information, in some cases subject to external audit. The ABI Guidelines include a list of ESG questions for companies to consider answering in their annual reports.

The Organisation for Economic Co-Operation and Development's Guidelines for Multinational Enterprises14 are another ESG voluntary framework available to UK companies. These guidelines advise regular disclosure of value statements, codes of conduct and performance against such codes, and general ESG compliance.

3.2 Standard-listed companies

Standard listed companies have the same voluntary reporting opportunities as premium-listed companies (please see paragraph 3.1 above).

3.3 AIM

The Quoted Companies Alliance produces voluntary corporate governance guidelines for small companies and AIM companies (the "QCA Code")15 which recommend publication of an annual governance statement as well as information on corporate social responsibility activities. Often institutional investor guidelines, such as the National Association for Pensions Funds' guidelines, will expect AIM companies with high market capitalisations to voluntarily comply or explain with regards to the CGC (please see paragraph 4

[12] http://www.iso.org/
[13] www.ivis.co.uk/PDF/7.1_ABI_RID_guidelines.pdf
[14] www.oecd.org/dataoecd/56/36/1922428.pdf
[15] http://www.theqca.com/shop/guides/

below). Normally, AIM companies will declare their intention to voluntarily comply or explain with regards to either the QCA Code or the CGC.

Otherwise, AIM listed companies have the same voluntary reporting options as premium-listed companies (please see paragraph 3.1 above). They might also voluntarily adhere to the mandatory reporting requirements for premium-listed companies as set out at paragraph 2.1 above.

4. What are the "comply or explain" reporting requirements of public companies whose securities are traded on the LSE regarding their actual or potential ESG risks or impacts?

Public companies traded on the LSE are generally subject to "comply or explain" reporting requirements with respect to applicable principles of corporate governance.

The CGC has enjoyed strong support in the UK as a model compilation of good corporate governance practices. The companies to which it applies are expected to use it as a benchmark for measuring their performance in the corporate governance area.

The CGC is administered by the Financial Reporting Council, which is the UK's independent regulator responsible for promoting high quality corporate governance and reporting in order to foster investment. The current edition of the CGC was published in September 2012 and applies to reporting periods beginning on or after 1 October 2012.

The CGC contains 18 main principles of good governance. Each principle is supplemented by a set of supporting principles and code provisions. The way the CGC operates is that it requires companies subject to it (either mandatorily or voluntarily) to report to their shareholders on the extent of compliance with it. Shareholders can then decide whether they are satisfied with the company's corporate governance practices. A company may choose not to adopt certain provisions of the CGC, or other guidance, if it can achieve good governance by a different means more compatible with its culture and organisation. It is essential, however, that in their annual financial reports to shareholders companies explain their reasons for not following guidance clearly and carefully. In providing an explanation, companies should aim to illustrate how their actual practices are (i) consistent with the principle to which the particular provision relates and (ii) contribute to good governance. The LSE has published an extensive Corporate Governance Guide which covers all aspects of the corporate governance framework in the UK and which can be downloaded from the LSE's website.

The nature and extent of a company's obligation to "comply or explain" with regard to the CGC depends on the nature of the listing of that company's securities.

Note that the CGC does not contain specific recommendations on environmental, social or employee matters, however several of its principles could implicitly cover such issues, in particular:

Principle C.1 of the CGC requires the board of directors to "present a balanced and understandable assessment of the company's position and prospects" in its financial reports. This could include reporting on environmental, social or employee issues where these are expected to affect the company's business; and

Principle C.2 of the CGC requires the board of directors to "maintain sound risk management and internal control systems". This includes managing environmental, social or employee risks where these are expected to affect the company's business.

4.1 "Comply or explain" for premium-listed companies

Rule 7.2.1 of the Disclosure and Transparency Rules requires a premium-listed company to include in its directors' report a so-called "corporate governance statement". The statement identifies the corporate governance code to which it is subject (e.g., the CGC), states where the relevant code is publicly available and indicates which parts of such code it departs from and the reasons for doing so (Rules 7.2.2 - 7.2.3 of the Disclosure and Transparency Rules).

Under Rule 9.8.6(6) of the Listing Rules, a premium-listed company should include in its annual report to its shareholders a "comply or explain" statement in relation to the CGC. Such statement should explain how the company has applied the main principles of the CGC and whether it has complied throughout the reporting period with all the relevant provisions of the CGC. Where the company has not complied with such provisions, it would need to provide an explanation as to why it has not done so.

4.2 "Comply or explain" for standard-listed companies

Standard-listed companies are not required by the rules set by the FCA to produce a "comply or explain" statement in relation to the CGC. However, a company with a standard listing may voluntarily decide to apply a corporate governance code (which may be the CGC or another relevant code).

Similarly to premium-listed companies, companies with a standard listing should include in their directors' report a so-called "corporate governance statement", in which they identify the corporate governance code which they have chosen to apply, state where the relevant code is publicly available and indicate which parts of such code they depart from and the reasons for doing so. If the company has decided not to apply any provision of such a code, it should explain its reasons for that decision. These requirements are contained in Rules 7.2.1 - 7.2.3 of the Disclosure and Transparency Rules.

4.3 "Comply or explain" for companies admitted to AIM

A company seeking admission to AIM should include in its admission document a statement as to whether or not it complies with its home

country's corporate governance regime(s). In the event that it does not comply with such a regime, a statement to that effect should be included together with an explanation regarding why it does not comply.

After the company is admitted to AIM, there is no continuing obligation on it to publish "comply or explain" statements. However, market practice is developing towards encouraging AIM companies to exercise stricter compliance with corporate governance principles.

For instance, the LSE's "A Guide to AIM" states that compliance with the CGC by AIM companies is widely regarded as good practice and has become expected of larger AIM companies. Many investing institutions expect their investee AIM companies to comply with the CGC or to set out the reasons for non-compliance in much the same way as Main Market companies.

As mentioned in paragraph 3.3 above, the QCA Code recommends that AIM companies should publish an annual governance statement.

5. Does the LSE have a Sustainability Index (or something similar) which tracks publicly listed companies' performance in ESG related areas?

While the LSE itself does not have a Sustainability Index, it does co-own (in partnership with the Financial Times) the FTSE, which publishes the FTSE4Good Index series. This series was launched in 2001 and seeks to measure UK companies' performance against global corporate responsibility standards. The index excludes companies which operate in the tobacco, nuclear and arms industries.

There are also numerous ESG rankings which are not linked to the LSE. For example, the Carbon Disclosure Project and the Business in the Community Corporate Responsibility Index both use companies' questionnaire responses to provide rankings.