Sustainability and UK plc

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There is no doubt that COVID-19 and its impacts are forcing society and governments around the world to reassess their priorities. Society more than ever values sustainability and, as we exit from COVID-19, there is growing pressure on governments to put sustainability at the centre of economic and social policy in order to address some of the fundamental issues that we face: building a stronger economy that ensures long term health and wellbeing for all, job creation and a more resilient and inclusive society.

Resolving the climate crisis is also high priority. At the current time, 126 governments have committed to net zero by 2050 including, crucially, China, Japan and North Korea. Positive change on this front also looks likely in the US under Biden's leadership. To help deliver net zero, governments will need to implement significant green stimulus measures which will inevitably include changes to law and regulation and all in short order. For example, France has recently announced that it will introduce an "ecocide" law designed to punish those who deliberately damage the environment. Offenders could be fined up to EUR 4.5m or imprisoned for up to 10 years. We can only expect more new law and regulation designed to deliver similar impact, as the recent announcement of the UK Government's Ten Point Plan for a Green Industrial Revolution and the Chancellor's new green finance-related measures amply demonstrates.

Governments, however, can't deliver a more sustainable, greener economy and a more resilient and inclusive society alone. Companies also have responsibility in this regard. Many companies are already voluntarily adopting new strategies which are grounded in purpose and address pressing social and environmental issues. They're doing this for various reasons but principally because: their consumers, regulators, employees, investors and other stakeholders demand it; they see significant opportunity in these new business models; and an increasing body of "hard" and "soft" law is forcing companies to put ESG considerations at the heart of who they are and what they do.

Sustainability and London listed companies

Here in the UK, we are already on a path which requires companies with a premium listing in London to take ESG considerations into account when making decisions. An example is the annual reporting requirements set by the UK Corporate Governance Code (the "**Code**") which require a company to disclose how the governance of the company contributes to its long term sustainable success and how it achieves wider objectives for stakeholders. Another example is the requirement for companies to report publicly on how directors have delivered on their success duties as set out in section 172 Companies Act 2006.

The Code isn't "hard" law as it's not a set of rules that are embedded in statute. However, the Financial Conduct Authority's Listing Rules require all premium listed companies to report annually on how the company has applied the Code's principles. This is described as the "comply or explain" principle – a company must say if it has complied with the Code and, if it has not done so, it must explain why it has failed to comply. If shareholders take issue with any failures in Code compliance they will seek to engage with the board in an attempt to resolve their concerns.

The intention of the Code is to encourage companies to make disclosures that enable investors to assess how the company is performing on ESG matters. To do this, the Code focuses on:

- Long-term sustainability and purpose – this represents a major shift in emphasis from the Code's predecessor, with the current version of the Code requiring disclosures on a company's role in society and how it engages with all those affected by it.

- Culture – this is based on the assumption that a healthy culture is necessary for a company to achieve long term sustainability and success, while poor culture is a risk to the business. To establish an appropriate culture, a company is encouraged to define its purpose, strategy and values and, in doing so, properly consider the behaviours that it wants to promote. The intent here is to ensure that all boards have issues of people and culture front and centre when making decisions which will help avoid a repeat of some of the corporate scandals and failures experienced by UK plc in the past.

- Diversity – the need for a high-quality and a diverse board in terms of gender, social and ethnic diversity to help drive stronger decision making and underpin the company's culture and purpose.

We also recently heard from UK Government that a new Listing Rule is to be introduced which will require premium listed companies to make annual disclosures against the Taskforce for Climate-related Financial Disclosures ("**TCFD**"). The final rules are expected to be published at the end of this year. However, it is anticipated that this new disclosure requirement will operate (at least initially) on a comply and explain basis (like the Code) as it is recognised that many listed companies do not yet have the systems and procedures in place to allow them to properly measure compliance against the TCFD requirements. The longer term intention, however, is for the disclosure requirement to become "hard" law applicable to all London listed companies (not only those with a premium listing) and to large private companies also. The new reporting requirements will apply to financial years beginning on 1 January 2021, so the first disclosures against the TCFD requirements will be available in annual reports published in 2022. Whilst companies have a while to prepare for the required disclosures, meaningful compliance with the new Listing Rule requires planning now on how to use the TCFD framework and on how best to measure, model and disclose the climate risks and opportunities companies are exposed to today and in different future climate scenarios.

Is this enough?

For many, the laws and regulations introduced by governments do not go far enough to deliver the changes required to protect people and planet as quickly as change is needed. There's also a view that companies and their shareholders are not yet doing enough to ensure that they operate in a sustainable manner.

Take the Code for example. Research from the Financial Reporting Council (who are responsible for the Code) suggests that many companies are struggling to articulate their culture and are simply seeing the Code disclosure requirements as a tick-box requirement. If that's the case, it will be interesting to see how stakeholders react – if they see non-compliance with the Code as an issue, they are likely to engage with the company and, if insufficient progress is made to correct the failure, shareholders could agitate for change which could lead to them using their ultimate weapon and voting to remove the board.

We've also recently seen powerful investors using their "weight" to force companies and other stakeholders to change their behaviours. Recently, Climate Action 100+ – an initiative involving over 500 global investors with over US$47 trillion in assets – wrote to the CEOs of 161 of the world's largest greenhouse gas emitting companies calling on them to put in place transition plans to deliver net zero and to provide targets which support delivery of those plans.

We have also seen direct action to tackle global warming from investors. In October, funds run by Sir Chris Hohn successfully forced Spanish airport group Aena to change its constitution so that shareholders of Aena now have an annual climate vote. And, just recently, we've learned that the campaign run by these funds continues with the filing of climate related resolutions on other companies, including Alphabet and Moody's.

U.N. climate envoy Mark Carney is also supportive of the need for companies to create transition plans and for shareholders to be given a "say on transition" at each annual general meeting – the "say on transition" means that a company's TCFD report would be put to shareholder vote at each AGM. Shareholders can then either vote to accept or reject that report – the point being that if the TCFD report is rejected, it's because the board isn't going far enough on environmental matters. In Mark Carney's view, the "*say on transition*" would establish "*a critical link between responsibility, sustainability and accountability*".

What does this mean for UK companies?

In short, it means that if sustainability, and what it means for a company, is not yet high on the board agenda then it needs to be and quickly. Whilst the UK already has legislation in place to drive ESG reporting by companies with a premium listing in London, it's unlikely that the existing legal and regulatory framework will stand still for long and further changes should be expected including, an extension of the application of the TCFD reporting requirements to non-listed UK companies and, potentially, a "say on transition" vote at each AGM.

Forward-thinking companies will want to re-examine their governance structures, funding requirements, supply chains and business plans through the ESG lens and make changes necessary to ensure that the company is appropriately positioned on sustainability issues and continues to be successful in the long-term. Failure to take action now, will see a company falling behind its competitors and may, in the worst cases, lead to that company's failure.

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