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Dear UK Sustainability Disclosure Technical Advisory Committee

BVCA Feedback on UK endorsement of IFRS S1 & IFRS S2 (UK Sustainability Disclosure Technical Advisory Committee Call for Evidence)

The British Private Equity & Venture Capital Association (BVCA) is the industry body and public policy advocate for the private equity and venture capital (private capital) industry in the UK. With a membership of around 650 firms, we represent the vast majority of all UK-based private capital firms, as well as their professional advisers and investors. In 2022, £27.5bn was invested by private capital into UK businesses in sectors across the UK economy, ranging from consumer products to emerging technology. There are over 12,000 UK companies backed by private capital which currently employ over 2.2 million people in the UK. Over 55% of the businesses backed are outside of London and 90% of the businesses receiving investment are small and medium-sized enterprises (SMEs).

The UK's private capital industry has a leading role to play in global efforts to eliminate the causes and combat the effects of climate change. As either majority or significant minority owners, principally of unlisted, fast-growing SMEs, private capital funds managed by BVCA member firms are well-placed to drive transition in areas of the UK and global economies that public markets cannot reach. This includes backing innovation that creates the technology needed to fight climate change and supporting businesses to transition to a low carbon economy.

Structure of private capital

Private capital firms are long-term investors, typically investing in companies for around 3-7 years in fund structures that typically subsist for 15 years. This means a commitment to building lasting and sustainable value in the businesses they invest in.

Private capital firms raise capital to invest from sources such as pension funds, endowments, insurance companies, banks, family offices/high net worth individuals and sovereign wealth funds (together, limited partners). They typically use a limited partnership to structure funds and an example of a structure is set out below.

- The general partner of the limited partnership fund will delegate its power and authority to the private equity manager (often limited liability partnerships with the partners being the executives).
- Private capital firms will manage one or more funds. The funds are closed-ended meaning that they have a limited life span, the industry standard being between 10 to 15 years. The life span of a fund can be extended (if permitted in the fund's constitutional agreement) and this is typically contractually up to two additional years with an option to further extend the life of the fund where assets have not been realised.
- Private capital firms raise capital to invest from multiple sources. These overwhelmingly institutional and well-informed investors will be limited partners in the fund and their liability is limited to the capital provided to the fund.
- The fund will typically invest in 10-15 portfolio companies in the earlier part of a fund's life until an agreed date (e.g. 5 to 10 years), and exit investments in the run up to the fund's fifteenth anniversary.

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Earlier stage investors may invest in up to 30-40 smaller portfolio companies. Typically, firms will sell their stake in a company by listing on the public markets or, more frequently, selling to a strategic buyer.

- The fund's ownership percentage in the portfolio companies will vary depending on the private capital strategy (e.g. buyout, minority stake).
- Private equity acquisitions will often be partly financed by debt, often provided by a number of banks.
- The portfolio companies will operate entirely independently of each other.
- The fund manager will typically have the right to appoint a representative(s) to the board of directors of its portfolio companies.

Support for a global baseline for sustainability disclosures

The private capital industry is international and invests and operates across borders. The BVCA therefore supported the ISSB's work in creating a global baseline for sustainability disclosures, as this will enable consistency in reporting and better comparability across businesses, which in turn should support the functioning of capital markets internationally. We support the priority work on climate and have been engaging on a range of sustainability topics with government departments as well as regulators both here in the UK and in the EU.

As we refer to throughout this response, the BVCA believes that the need for global cooperation is of the utmost importance. In the UK and EU alone, we note that there are a whole host of competing regulations, reporting standards and requirements, and initiatives currently putting additional costs and pressures on the private capital industry. If these can be brought under an umbrella framework, we believe that there will be more clarity and consistency around sustainability reporting.

UK implementation of standards

The BVCA supports the UK Government's framework to create the UK Sustainability Disclosure Standards (UK SDS) by assessing and endorsing the global corporate reporting baseline of IFRS Sustainability Disclosure Standards (IFRS S1 & S2). We welcome the opportunity to respond to the UK Sustainability Disclosure Technical Advisory Committee's (TAC) call for evidence and will support both the TAC and the FRC/government with their implementation of the UK SDS. The introduction of IFRS S1 & S2 via the UK SDS and future sustainability standards will undoubtedly enhance sustainability reporting in the UK.

Alignment with global standards

There is a need for global cooperation, which, positively, is referenced in the call for evidence. For example, by aligning the IFRS S1 & S2 standards with the Taskforce on Climate-related Financial Disclosures (TCFD) framework, the standards promote consistent disclosures of climate-related information, allowing investors to assess an entity's exposure to climate risks and evaluate its resilience and adaptability in a standardized manner. Private capital funds operating internationally will benefit from these harmonization efforts.

The IFRS S1 & S2 standards are also designed to align with existing accounting requirements, which is positive. With over 140 jurisdictions already requiring IFRS Accounting Standards, IFRS S1 & S2 create a global baseline for sustainability reporting. This alignment facilitates consistent understanding and evaluation of sustainability factors across borders and will enable easier adoption as entities will not have to recreate but will instead be able to transfer reporting processes and data. Private capital funds can benefit from companies being evaluated under a homogenous standard, which will streamline reporting processes, reduce duplication and improve comparability.

Potential impact of the UK SDS on private capital

Private capital structure (firms, investors and portfolio companies)

Private capital firms, their investors and portfolio companies will all be impacted by the implementation of the UK SDS. The data gathering, the processes involved, and the resulting reporting will require significant resource, resulting in substantial costs and additional assistance from external advisors, many of whom may not have the increased expertise and bandwidth to provide such services.

- Limited partners
  In the vast majority of cases, there will be more than one limited partner invested in a private capital fund, and depending on the type of limited partner, different reporting may be required. Limited partners are a primary user of accounts in our industry and the reporting can vary. It may be a difficult task for general partners to provide bespoke information to each limited partner to meet their own UK SDS requirements, unless the data requirements of the standards are clear, concise and consistent.

  Limited partners seek increased transparency and reporting from general partners in order to inform and guide their boards, trustees, portfolio managers and risk departments. To serve these various constituencies, investors repeatedly inquire with general partners about their investment activities. Standardised best practices and reporting templates improve transparency and generate industry efficiencies and putting these in place takes considerable amounts of time and resource. Phasing in the requirements will be critical while the industry puts in place the practices and processes so that investors receive the information they require in a consistent form across all general partners.

- Portfolio companies
  As we note in our opening remarks, there are over 12,000 UK companies backed by private capital which currently employ over 2.2 million people in the UK. 90% of the businesses receiving investment from our members are SMEs. These companies are the backbone of the UK economy, and their focus is primarily on innovation and growth. While we agree that more sectors of the economy need to report on sustainability related matters, the likelihood of these SMEs being able to implement these standards is questionable. Many SME portfolio companies, particularly those at the earliest stage of their growth (Seed – Series B) simply do not have the expertise, resource, systems and data collection processes in place to be able to report in accordance with the UK SDS.

  Private capital will be there to assist these companies, however, similarly, they are focused on innovation and growing their portfolio companies into better businesses. It will take substantial time and resource for SMEs to align with these standards and we would advocate for them to be phased in for SMEs over an extended period to enable effective adoption with a minimum threshold for in-scoping, indexed to materiality.

- Private capital firms
  The new rules will require private capital firms to address sustainability related issues in a number of areas, including data, methodology, professional expertise, deal execution and value chain monitoring. Significant new burdens will be placed on private capital firms not only in terms of disclosure, but also in reshaping their processes to be more sustainable.

In preparation for potential future mandatory reporting, firms will need to work with their portfolio companies to identify gaps in their data collection and reporting processes. For example, if a company has never collected greenhouse gas (GHG) emissions, they will be required to begin collecting this data. It is not uncommon for companies to require multiple reporting cycles to optimize their data collection processes and, in turn, use this data for business transformation.

The new range of issues, including monitoring and data collection, is exacerbated when you consider that private capital firms can typically manage multiple funds, each of which contain investments in a number of portfolio companies. These portfolio companies can and will be different sizes and operating across a wide range of sectors and potentially geographies. Our members invest in all sectors, ranging from emerging technologies to heavy industry to consumer goods. Adding to that the requirements around value chains, the implementation of these standards will require substantial work.

The TAC should carefully consider the how the implementation of the standards affects the three types of entity above, including the complexity, skills shortage, additional costs and the time it will take for implementation.

Assurance on sustainability reporting

Additional assurance will be required, and many private capital firms are starting to explore assurance for sustainability reporting, for example on TCFD. We believe that accounting firms and other professional services providers and specialists, are not yet sufficiently resourced or indeed skilled to complete this difficult additional work. Auditor independence exacerbates this issue as there is less choice of service provider for many of the larger private capital firms and portfolio companies. The skills will need to be developed which will take time, and in the interim, the related costs will be higher than many anticipate.

The TAC should carefully consider the skills shortage, the additional costs and the time it will take individuals responsible at companies (large and small) to complete the audit (varying levels of assurance) of a completely new data set. It may almost amount to a second audit if the data set is vast and reasonable assurance is required.

Scope and phasing in of requirements

In applying the UK SDS, businesses and asset managers will be required to invest substantial additional capital to cover the significant costs of evolving their investment and reporting processes which will entail significant costs – noting that the market for service providers with specialist expertise and products/services is still also nascent in places. As we set out in great detail, due to the structure of private capital and how it engages with investors and its investments (portfolio companies), the implementation of the UK SDS will have a profound impact, particularly in the early stages of its implementation and a company's alignment.

The scope is currently unknown, and it will be important to understand the views of the FRC/government on the thresholds that will bring an entity into scope. It will be equally important to understand who the standards will apply to and when, as well as the phasing in periods for each type of entity. We believe that phasing should adopt recognised pre-existing criteria/categorisation (e.g. phased implementation of TCFD) and should happen over a number of years, starting with the largest quoted companies and moving down to those SMEs who meet a minimum set of pre-defined criteria. We would also recommend that the "climate first" transition option, which allows an entity to provide only climate related disclosures in its first year, is included in the UK SDS. Additionally, due to difficulties which can be experienced with collecting Scope 3 emission data (due to the indirect nature of emission to an organisation) we would recommend that further consideration is given to how materiality is factored into the implementation of

UK SDS and how this can be phased for each organisation once within scope, to ensure data sets which are disclosed are as representative of an organisation's operation as possible.

Our suggestion for phasing in is below:

Phase 1 – "Climate first" transition option available
Phase 2 – Full implementation of the UK SDS, excluding Scope 3 emissions
Phase 3 – Full implementation with partial inclusion of Scope 3 emissions – financed emissions (if an entity is a private capital fund)
Phase 4 – Full implementation of the UK SDS

The above phasing could be introduced in annual or bi-annual increments (having regard to the relative complexity of each stage, particularly in relation to data gathering) and would apply to each category of entity (quoted, private, asset manager, SMEs meeting a pre-defined criteria) over a number of years.

BVCA key recommendations and response to questions

As we have set out above, private capital firms will be faced with a number of requirements and additional work following the implementation of the UK SDS – requiring close management and rigorous data collection from portfolio companies and reporting to investors about those same portfolio companies. The industry is committed to sustainability and reporting on sustainability metrics, however, careful consideration of the structure of private capital, the resources that will be needed, the professional advisors that are not yet available, the nascency of the approaches and systems to collecting data of this nature and the cost this will involve is vitally important to the successful implementation of the UK SDS. Indeed we fear that a less thoughtful approach to implementation may lead to unintentional consequences of poor engagement and/or poor datasets as firms and companies alike struggle to resource the level of work needed.

Additionally, it will be very important to ensure that:

- Phasing in of the standards is proportional and reflects the additional burden and costs that private capital firms and portfolio companies will face.
- Concerns around assurance and external advisors are taken into consideration, and the conditions for initiatives such as training and upskilling are created in accounting firms and other specialist advisors.
- That private capital structures are not considered corporate groups, for reporting purposes and in line with IFRS. Each portfolio company operates independently and there is no consolidation with the fund or private capital firm. Reporting on sustainability and value chain will need to reflect these facts.
- Value chain is defined carefully and clearly, and the requirements around value chain are phased in slowly to allow for the skills, data and resource required to develop.
- Materiality can be adapted to suit the sector that the company operates in, as what is material to an emerging technology SME may not be relevant to a large consumer goods company.
- Guidance is created to explain the new terminology included in the standards (sustainability related risks and opportunities, for example).

We have limited our response below to areas that are of concern to our members. Please see the appendix below.

Please do not hesitate to get in touch if you have any questions or if you would like to discuss any of the above in more detail (please contact Harriet Assem, hassem@bvca.co.uk and Ciaran Harris, charris@bvca.co.uk).

Yours sincerely,

Jonathan Martin

Chair, BVCA Accounting, Reporting & Governance Committee

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Appendix

1. Overall views of the standards

To what extent will the requirements in the standards improve upon existing reporting in the context of the UK?

As we have touched upon earlier in our response, we believe that bringing in existing frameworks and regimes like TCFD as well as convergence with the Sustainability Accounting Standards Board (SASB) and Carbon Disclosure project, will reduce burden for the large private capital firms. If implemented proportionally and with a material lens on, the standards have the ability (over time) to streamline and reduce reporting burden over time, whilst also enabling consistency in reporting.

Other frameworks/regulation should be considered, including the EU Corporate Sustainability Reporting Directive (CSRD), which may cause duplication. Similarly, in the UK, there is likely to be overlap and duplication between S2 and FCA requirements in place for commercial premium listed companies (PS20/17) and asset managers (PS21/24) to report on climate change risk management using TCFD framework. Additionally, FCA is planning to publish Sustainability Disclosure Requirements (SDR) and investment labels policy statement in Q4 2023 that might result in further overlap between the reporting requirements. We would advise the UK TAC to carefully consider all of these separate but additional reporting requirements that will affect reporting in the UK with the goal of increasing alignment.

The need for global co-operation and co-ordination between different jurisdictions, as well as domestic alignment between different but competing frameworks, is essential to improve upon existing reporting and for this to work effectively and reduce impact and costs. Many PE/VC firms have asset management and advisory entities, funds, and portfolio companies in different jurisdictions and will have to comply with regulation and reporting standards in the UK, EU and US.

Development of a global disclosure language will help support capital markets in the UK. The private capital industry is international, investing and operating across borders. Convergence around the disclosure language will enable consistent and comparable reporting across businesses, supporting sustainable capital markets in the UK and internationally.

To what extent do you think that application of the standards in the UK is technically feasible?

We believe, with the correct phasing in, international alignment, guidance and assistance, that the application of the UK SDS in the UK is technically feasible. We would point you to our response above.

2. Identifying sustainability-related risks and opportunities

The definition of what sustainability-related risks and opportunities are needs clarity and guidance in order for readers to understand what they must report on. With the current explanation included in the Standards, one could list a whole host of risk and opportunities that might not be relevant for the primary user of the accounts (which can have many and with varying needs in private capital). The definition should state that risks and opportunities are not meant to be too prescriptive and there should be clear linkage to general business register risks that the majority of businesses would typically face.

Materiality is important to note here as it relates to identifying sustainability-related risks and opportunities. Materiality is subjective and whilst there needs to be an element of subjectivity allowed to allow for reporting to be reflective of the individual nature of organisations - to enable verification of data, comparability of disclosures and ease of adoption - further clarity is required around what should be considered sustainability risks and opportunities to prevent divergence. This should also be reflective of the wider sustainability regulation landscape e.g. what will SDR require you to disclose on and consider

material. Refinement of what may be considered a sustainability risk or opportunity with consideration of other sustainability regulations needs may reduce the need for additional frameworks and enable standardisation.

IFRS 1 B11 and B12: The specific topics referred to in IFRS 1 B11 and B12 could potentially have big implications for the private capital industry. Clause B11 (a) (b) and (c) refer to changes that in the private capital industry that could conceivably mean that firms and their portfolio companies are required to constantly reassess sustainability-related risks and opportunities. The definition of "value chain" could mean hundreds of companies are involved (due to supply chains and product and service providers) and it is common occurrence in the private capital industry for portfolio companies to merge or acquire other businesses. This could create hugely burdensome requirements on private capital firms and their portfolio companies. "New regulation" (IFRS 1 B11 (c)) should be narrowly defined to only include what is deemed to be of importance to sustainability.

3. Application of materiality

The definition of materiality looks problematic and will be difficult to apply in a private capital context. What may be material for one portfolio company or limited partner may not be for another portfolio company or limited partner, making it difficult for the private capital firm to manage competing priorities and reporting on those. Please see our response to "Identifying sustainability-related risks and opportunities" for further comment. Additionally, there should be a layer of objectivity applied to de minimis thresholds at the earlier stage of investing (Seed/Series A Firms) and to their underlying portfolio.

Further guidance is needed to assist the private capital industry in how to translate the materiality definition given the competing priorities the industry can face.

4. Reporting approach

We agree with the reporting approach. However, there is a question around the linkage between the Strategic Report and the notes to the accounts. We expect that some of the information that will be included to implement the UK SDS will need to be linked to the backend of the accounts where quantitative information (for example, around impairment of assets or asset depreciation) that may be relevant to sustainability reporting. The instances where this might occur should be minimum and guidance should be produced to assist.

5. Timing and location

We agree with the timing and location and would point to the "reporting approach" outlined above for our views on the Strategic Report.

6. Judgements, uncertainties and errors

Sustainability data is new and remains weak in places, most acute at the earlier stage of a company's development. It will take time for businesses to improve their collection and reporting. Carbon data, especially for scope 3 emissions can, in many cases, be based on estimates which may not always been organisation specific. We would question the value of disclosing this information if the data is inaccurate or the data set is likely to change and would ask the TAC to consider thresholds and, more importantly, phasing in.

Reporting on judgements and uncertainties could end up becoming the bulk of the reporting and as such we would again question the value. We think the result will be a large reporting of errors, which will require businesses to do additional work, opening up closed reporting periods.

7. Financial impact and connectivity

Materiality: Materiality plays a crucial role in determining the scope of disclosures. Both IAS 1 and IAS 8 emphasise the importance of disclosing material information in financial statements. Materiality needs to be assessed considering both quantitative and qualitative aspects. Having said that, climate-related issues could be considered significant based on their nature, even if their numerical impact on financial statements is not substantial. In cases like climate-related issues, it will be difficult for private capital firms to determine materiality based on nature rather than just numerical impact. How should quantitative and qualitative factors be balanced in the evaluation? This evaluation could involve a significant degree of judgment given the various sizes and types of businesses private capital engages in.

Connected information [IFRS S1 (paragraphs 21–24, 34–40 and B39–B44)]: Private capital entities often engage in a wide array of investments and businesses. Harmonising disclosures across a portfolio of entities, each with its own unique sustainability strategies and governance structures, can present certain complexities. Consider, for example, a private equity fund with investments ranging from renewable energy projects to consumer goods companies. Ensuring that governance, strategy, and risk management disclosures seamlessly integrate across these diverse investments can pose a challenge. Maintaining uniformity in data and assumptions may also prove to be demanding. Let's take the example of a private capital entity investing in companies across various sectors, such as technology and agriculture. Each sector may adhere to distinct sustainability metrics and reporting standards, which can make it intricate to present information consistently. Questions arise as to how can private capital entities effectively integrate governance, strategy, and risk management disclosures across a diverse range of investments? It will be difficult to ensure uniformity in their reporting processes when investing in various sectors each with distinct sustainability metrics.

Financial position, financial performance, and cash flows [IFRS S2 (paragraphs 15–21 and B65)]: Quantifying the impact of climate-related risks and opportunities demands thorough data analysis and, at times, specialised resources. Moreover, the level of uncertainty surrounding these estimations can be quite significant and these specialised resources unavailable. To determine which climate-related factors might change a company's financial situation in the future, one needs to understand how the entities work and how they could be affected by things like climate change. This can be especially hard for entities that invest in lots of different industries. Including information about sustainability in financial reports is important, but for some companies, it's a big challenge to get and use this data. Portfolio companies, especially those without a lot of resources, will find it difficult to effectively gather and use sustainability data in their financial reports given these complexities.

We would recommend that guidance is created to assist firms with/to:

- determine materiality based on nature rather than just numerical impact;
- effectively integrate governance, strategy, and risk management disclosures across a diverse range of investments; and,
- implement the processes they need to put in place to collect the required data.

Our commentary links back to the need for phasing in, to allow for the time to integrate the required processes and successfully report under the standards.

8. Industry-based requirements

We note that convergence with SASB would be positive earlier in our response. However, it is also important to consider their applicability and appropriateness to all geographies and sectors, to enable consistency in reporting. In particular, noting the fact that the SASB standards were designed for American markets. Applicability of the standards to the UK market should be considered, with the UK regulatory landscape and market in mind.

We would also note that material sustainability risks and opportunities can be bespoke to individual organisations, making it difficult to standardise across an international platform. To prevent disclosures becoming a tick box exercise and not fully aligned with an organisations material sustainability risks and opportunities, (and the sectors and geographies it operates in whilst also enabling comparability/standardisation) we would suggest that any industry-based framework focuses on material common topics, and is positioned as a framework for an organisation to build from with guidance provided around what is considered a material sustainable risk and opportunity (as referenced before) to allow for the bespoke nature of organisations sustainability risks and opportunities to be captured. Given the range of sectors and geographies private capital may invest in, focusing on common topics will also enable for easier uptake in reporting and more accurate and robust reporting.

We would also advocate for the inclusion of the Global Reporting Initiative (GRI) as this can be more easily applied by smaller private capital firms and smaller portfolio companies.

9. Cross industry metrics

The difficulties and costs associated in obtaining Scope 3 emissions data and need for further consideration on transitional arrangements for reporting on Scope 3 emissions is well reported. Phasing in and significant guidance will be required to be able to provide data.

The value chain is the most onerous part of any organisation's carbon footprint to quantify and influence and can limit some organisation's ability to set meaningful science-based targets which they are confident they can achieve. Whilst it is recognised that the value chain has to be considered to ensure Net Zero can be reached, support with helping organisations, particularly SMEs, overcome the barriers they face when measuring their value chain is critical. These barriers can include the absence of sector specific guidance (which is just emerging) and the shortage of skilled and affordable service providers and advisors, limiting ability to gather representative data to make meaningful decisions from.

This could delay an organisation's ability to initially disclose data which is representative of their organisations, and we would request that further phasing of Scope 3 emissions data is allowed to ensure any disclosures are meaningful.

10. Costs and benefits

The introduction of UK SDS and future sustainability standards will require portfolio companies and private capital firms to invest further to evolve their investment and reporting processes and will entail significant costs (noting that the market for service providers with specialist expertise and products/services is still also nascent in places). Additionally, there will be the need to re-skill and indeed hire additional finance and other staff members while there are cost pressures for many and a skills and employee shortage in these areas.

11. Application of the requirements

Proportionality provisions: We agree with the provisions as set out in the Feedback Statement[1] referenced in the consultation document. However, as we have discussed earlier in our response, we believe that these should be supplemented with the phasing in approach we have suggested.

Reliefs: We agree with the reliefs, as proposed in the Feedback Statement.

Implementation and phasing: As we mentioned in the main body of our response, the market for service providers and advisors on climate and sustainability matters is evolving and growing as they seek to

[1] feedback-statement.pdf (ifrs.org)

deepen expertise and offerings. In the early years, costs of implementing any new standard as external advisors, auditors and preparers of financial statements familiarise themselves with requirements and expectations of users of the accounts (including suppliers and customers) are always higher. Given the subjective, forward-looking and qualitative nature of some of the disclosures, costs associated with assurance or verification of disclosures and judgements made will also be high. We would, once again, recommend phasing in the requirements, for example on Scope 3, where methodologies are still being developed.

12. Any further comments

ENDS