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Corporate sustainability disclosure standards: The way forward

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Environmental, social and governance (ESG), and especially climate, is now one of the dominant themes for global regulators and progress has accelerated at an astonishingly rapid pace this year.

There is a growing consensus that, amongst other things, climate change poses significant financial risks and that urgent, coordinated action is required to address them.

The EU's green finance agenda is ambitious, multi-faceted and increasingly sophisticated. But Europe only accounts for about 8.4% of global carbon emissions. It is evident that if climate considerations are to be properly taken into account throughout the investment chain, we will at the very least need globally consistent *corporate-level reporting standards*.

Although equivalence can be a technique to export some EU financial sector standards internationally, it cannot operate in the same way for non-financial corporations for the simple reason that they are not subject to the gamut of bank and market regulations where equivalence normally sits. So global standards have an inevitably vital role to play.

To advance this global consistency goal, the International Organization of Securities Commissions (IOSCO) has thrown its weight behind the proposal made late last year by the IFRS Foundation to establish a new global sustainability standard-setting board, the Sustainability Standards Board (SSB), which would fulfil a similar function to its existing International Accounting Standards Board.

The new board would create a comprehensive and harmonised corporate-level reporting framework, starting with climate, incorporating but also developing the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

However, concerns are emerging in the EU that the approach to climate reporting pursued by IOSCO and the IFRS Foundation and the different approaches in the EU could result in inconsistent or even conflicting standards, leading to confusion amongst the investor community and creating unnecessary burdens for reporting companies.

The European Financial Advisory Group (EFRAG) issued a paper in February 2021 setting out its own recommendations for EU non-financial sustainability reporting standards.

Note: This is the text of the speech as drafted, which may differ from the delivered version.

Parallels have been drawn with the well-known divergence between IFRS accounting standards and US Generally Accepted Accounting Principles (GAAP) which, despite considerable effort, have never fully converged. As in that case, differing climate and broader sustainability reporting frameworks could inhibit the ability of investors to compare disclosures, thereby impairing their ability to allocate capital efficiently across the global investment universe.

My main message today is to assure you that this outcome can be avoided and to explain why I believe this can be done.

To begin with, the IFRS Foundation's proposal is now central to IOSCO's work in this area. And this goes back to the fact that Europe only accounts for about 8.4% of global carbon emissions. If we are to move the dial on climate finance, it is essential that we establish globally consistent corporate—or real economy—climate reporting standards as a matter of extreme urgency to deal with the remaining 91.6%. Failure to do so would harm all of us, including the EU—no matter how good its own proposals are.

To start with the basics, we have recognised for some time that further progress across the whole spectrum of climate finance depends on more reliable, consistent and comparable climate reporting by corporates. Without this, financial sector firms, including banks, insurers and asset managers, will not have the information needed to assess climate risks on their balance sheets or make credible disclosures to end investors.

Good progress has been made under the TCFD umbrella. But its status reports have highlighted that the content of disclosures about the impact of climate change on companies' financial prospects and strategies has been disappointing.

On top of this, there are too many voluntary climate reporting standards for companies to choose from. And so greenwashing is also a major problem.

A major breakthrough

That is why the IOSCO Board decided to support the IFRS Foundation proposals to set up the new global sustainability standards board. Importantly, the IFRS Foundation and IOSCO are also collaborating on this project with the five major independent sustainability standard setters[1].

The IFRS Foundation is already responsible for global accounting standards. Our objective is for the new standards board to produce parallel sustainability reporting standards, starting with climate.

There are five reasons why we see this project as a major breakthrough.

First, content is critical. With IOSCO's strong encouragement, the five independent standard setters have already published a prototype financial disclosure standard which synthesises the TCFD recommendations as well as their own disclosure frameworks. As such, it provides a running start for the rapid development of an IFRS standard.

[1] The Climate Disclosure Standards Board, Global Reporting Initiative, International Integrated Reporting Council, Sustainability Accounting Standards Board and CDP (formerly the Carbon Disclosure Project).

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The prototype is based on the idea that climate reporting will sit alongside traditional financial statements reporting, with both operating as essential inputs for investors to determine enterprise value. The concept of enterprise value is critical.

The IFRS Foundation has already established a working group to evolve the prototype into the first corporate climate reporting standard. This standard will provide a global baseline, but it will be far from basic.

Second, good governance is assured. The new standards will be developed within the tried and tested IFRS standard-setting framework. IOSCO chairs the IFRS Monitoring Board which looks after the public interest dimension and will be closely involved in the institutional set up of the new standards board.

Third, this approach promises a pathway to eventual mandatory adoption. IOSCO has put together a technical expert group chaired by the US Securities and Exchange Commission and Monetary Authority of Singapore to look at whether IOSCO can endorse the developed prototype as the basis for a final reporting standard. Endorsement of the final standard would send a strong signal to IOSCO members to use it in their jurisdictions.

Fourth, speed is essential. With the running start we already have, the aim is to set up the SSB by November 2021 and for IOSCO to endorse the global climate standard as early as possible in 2022.

Finally, a global standard for climate reporting should be capable of being audited. For example, auditors should be able to challenge companies on links between climate reporting and conventional financial reporting.

In short, these standards will be positioned for adoption globally, will be scalable from the outset, will incorporate the materiality principle and will be adaptable across different economies and geographies.

Enterprise value

The concept of enterprise value is central to the prototype now being evaluated as the basis for an IFRS reporting standard.

This is against the background of concerns from the EU that this concept does not fit well with the “double materiality” idea at the heart of the EU approach.

Enterprise value focuses on information which is crucial for investors to assess the material financial implications of climate change for a company. It is about how climate and other sustainability issues can erode a company’s worth, or how they present opportunities which can create value.

It also reflects the dynamic nature of sustainability-related issues which may become more or less material over time as the business environment changes and investors raise their expectations.

Clearly, this type of reporting is distinct from broader sustainability reporting, the purpose of which is to illuminate a company’s most significant impact on the environment, people and the economy. But this does not mean that the IFRS proposals are inconsistent with double materiality. Far from it.

First, the five standard setters who drafted the prototype have stated their belief that sustainability reporting and sustainability-related financial disclosure must be seen as interrelated reporting concepts, with standard methodologies wherever appropriate.

Secondly, the prototype sets out a sophisticated "building blocks" approach to a more comprehensive corporate reporting system.

This starts with the information of most relevance to those with a specific interest in understanding enterprise value. It then scales up to include information relevant to users with various objectives who want to understand a company's positive and negative contributions to sustainable development.

With this approach, and the right level of ambition and cooperation, there should be no significant dislocations between the global and EU policies for sustainability disclosures.

In reality, enterprise value and double materiality are complementary concepts and will become even more so as investors demand more information about the material impact companies' activities have on the environment.

Compatibility

Current plans call for the new standards board to be set up before the 26th UN Climate Change Conference of the Parties and for a global climate standard to be published in 2022 for wide adoption across jurisdictions.

The timeline reflects the urgency of this work and that speed is of the essence.

With the EFRAG proposals, the EU now also has a roadmap for the scope and structure of future sustainability reporting standards for companies. I was pleased to see that one of EFRAG's key conclusions is that there is "significant merit in promoting mutually reinforcing cooperation between EU standard-setting efforts and other international initiatives".

As I mentioned earlier, a concern is that the world will be divided into two standards along the lines of IFRS and GAAP. I believe this fate can be avoided and that our different approaches are in fact compatible and can work together.

As a practical matter, I will ensure that further measures are taken immediately to more closely connect IOSCO's sustainability finance group—extremely ably led by Erik Thedéen, Chair of Sweden's financial regulator—and the IFRS leadership with the EU authorities, especially EFRAG.

In fact, IOSCO has proposed a multi-stakeholder consultation committee to operate within the IFRS Foundation structure; part of its job will be to promote consistency and comparability with jurisdiction-specific reporting standards.

Our collective responsibility

In conclusion, I would also like to acknowledge that there are still some serious technical challenges to be overcome in the area of climate and broader sustainability reporting, and we are far better off working on these together.

I have mentioned the fairly disappointing status reports published by TCFD. It should be our collective responsibility to cure these shortfalls through the evolved standards we are now all pursuing.

This will require far greater understanding around the content of scenario analysis, which lies at the heart of reporting on transition and physical climate risks, and should include collaboration with our central banking colleagues in the Network for Greening the Financial System who have been working on scenarios as an aspect of the prudential supervision of banks and insurers.

We also need to do far more in the area of data and metrics relevant to different business sectors and activities. And investors are now asking for specific disclosures to judge the credibility of a company's commitment to net-zero targets.

This just scratches the surface. All of this will require close international cooperation, to which IOSCO, the IFRS Foundation, EFRAG, the EU Commission and the EU's own International Platform on Sustainable Finance are all well placed to contribute.

Thank you.