IFRS Foundation Consultation Paper on Sustainability Reporting

Eurosif

EUROSIF RESPONSE

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Eurosif, the European Sustainable Investment Forum, welcomes the opportunity to respond to the consultation of the IFRS Foundation on Sustainability Reporting.

INTRODUCTION

About Eurosif

Eurosif works as a partnership of Europe-based national Sustainable Investment Forums (SIFs). SIF members include institutional investors, asset managers, index providers and ESG research and analysis firms totalling over €8 trillion of assets under management, as well as other stakeholders such as NGOs, trade unions, think-tanks and philanthropic foundations. Eurosif is also a founding member of the Global Sustainable Investment Alliance, the alliance of the largest SIFs around the world.

Our Mission is to promote sustainable development through financial markets by supporting the financing through private and public capital of investments that make a measurable contribution to the sustainable development goals set by the United Nations, the European Union and other European countries.

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Executive Summary

It is clear that the one of the main constrains that responsible investors face is the availability of high-quality, relevant, comparable and also verified data. This limits their ability both to integrate Environmental, Social and Governance risks in their portfolios, as well as their ability to allocate capital to sustainable investments with positive or neutral sustainability impacts.

Equally, our members who are predominantly based in the European Union allocate a significant portion of their assets or their clients' assets to investments outside the EU. As a result, an internationally coherent set of reporting requirement that help build comparable sustainability information across jurisdictions, across companies in different sectors as well as in the same industry is vital. Therefore, we encourage initiatives such as the one by the IFRS as well as standard setters that have agreed to work together (SASB, CDSB, IIRC, CDP, GRI) as long as these initiatives are meant to coordinate and simplify the landscape for sustainability reporting and do not end up adding additional layers of complexity.

The challenge with sustainability information is that it may need to serve a different purpose and follow a different approach than financial information.

Backward- and forward-looking information

First, financial information report by companies is by nature historical and backward-looking. Is if therefore also verifiable, auditable and therefore can be covered by assurances. While backward-looking sustainability information can be helpful, forward-looking information is at least as important and interesting as it allows users of statements such as investors to match this information against global and sector forecast and scenarios which have been defined to ensure optimal management of key sustainability goals (notably 2050 Climate Neutrality, conservation of biodiversity, etc…). However, since this corporate information is forward-looking estimates, it is not possible to subject it to the same level of assurances as backward-looking sustainability or financial information.

Double materiality

Secondly, a critical piece of any sustainability reporting framework is which notion of 'materiality' is used to determine which information needs to be reported. Some frameworks focus on financial materiality, taking a financial investor-centric and risk-based approach. Other frameworks, notably in the EU (Non-Financial Reporting Directive), also require publication of environmental and social materiality, taking a 'double materiality' approach. Eurosif is very supportive of the latter, more extensive, approach, which is needed to enable investors to integrate corporation's societal impact into asset allocation decision.

Indeed, many of the global sustainability challenges we face, from climate change, loss of biodiversity to scarcity of drinking water, all have in common that they are underpinned by 'negative externalities' which are not internalised by economic actors: these do not pay the true costs linked to their economic activities. Correcting these negative externalities require ambitious government policies and regulations to price these correctly, for example through taxes or emissions trading systems for CO2 and other GHG. In the absence of such policies and regulations inducing a correct price, a sustainability reporting system based solely on financial materiality will not extract vital information on these externalities as they may not be financial material to the reporting company. Therefore, while we hope that governments globally will enact and promulgate the appropriate policies to mitigate climate change, counter biodiversity loss and address social issues, in the meantime a sustainability reporting standard underpinned by 'double materiality' will deliver the necessary level of transparency for governments, stakeholders, markets and investors to understand and start addressing and factoring in these externalities.

Key recommendations

Our key recommendations to the IFRS for the creation of a Sustainability Standards Board (SSB) can be summarised as follow:

- **Materiality** – From the start, the ultimate future objective of the upcoming work on Standards should be 'double materiality', while acknowledging that different parts of the world may be advancing at different pace on the environmental and social materiality. Keeping the focus solely on financial materiality means that the SSB would from the start be less relevant for certain jurisdictions such as the EU.
- **International coordination important, but not an end in itself** – We believe the SSB could contribute to more international coordination of sustainability reporting, particularly when it comes to 'financial materiality' and the technical definitions and standards used to determine that. However, full international harmonisation should not become the board's key goal in itself and should not preclude jurisdictions such as the EU to pursue a higher level of ambition with a more ambitious timetable. On the contrary, the most ambitious and advanced frameworks – such as the European one – should set the base for the international dialogue and be considered as a model to aspire to, with due regard for the peculiarities of the single jurisdictions.
- **Scope of sustainability issues addressed** – While we appreciate the rationale of the IFRS to suggest that the SSB should first and foremost focus on climate-related sustainability reporting, we believe that a narrow focus on only one sustainability objectives can lead to misguided policies and reporting. Sustainability is broader than climate or the environment (E) only and should also cover social (S) and governance (G) issues. Therefore, we believe that to be relevant, the SSB should commit to taking a holistic approach to sustainability from the start. That may involve starting with climate change, but we would expect a clear timetable and roadmap from the SSB on addressing these other issues as well.
- **Mission, Governance and Scope** – Whenever new institutions are created, it is essential that the mission statement, scope of work and governance structure are well articulated and future proof. To meet that bar, the SSB mission should be to focus on financial as well as environmental and social materiality. It should commit to address sustainability in a holistic approach. And it should have transparent and clear decision-making processes where a diversity of stakeholder representation is guaranteed. Sustainability reporting will increasingly touch on issues which are at the core of the political and societal discourse in democratic societies. The SSB may therefore be subject to much greater scrutiny in its decision-making than the IASB and therefore its decision-making process should be robust enough to ensure that its standards are inclusive and accepted.

RESPONSE TO QUESTIONS

1. **Is there a need for a global set of internationally recognised sustainability reporting standards? Is yes, should the IFRS Foundation play a role in setting these standards and expand its standard-setting activities into this area? If no, what approach should be adopted?**

Widespread availability of comparable, high-quality and where possible verified sustainability data is one of the missing linchpins to ensure a further scaling of responsible ESG investing aiming at seeking sustainable outcomes. And since many of the sustainability challenges we face are global (climate change) or at the very least regional (biodiversity loss), exceeding the borders of a single jurisdiction, and investors' asset allocation is global, there is a clear need for a more standardised and harmonised reporting of sustainability data.

While there is a flurry of innovation, we are at the stage where there are too many reporting standards, seeking different objectives and underpinned by different approaches. And many of these standards are private-market, voluntary, industry led initiatives. While they can be helpful at an initial stage, at some point policies and regulations promulgated by public authorities are required to ensure we reach the adequate level of coverage, implementation and comparability. The IFRS Foundation with it recognised role in financial reporting could therefore have a role to play, as long as its initiative is meant to coordinate and ensure mutual understanding between different approaches. Otherwise, it would just be added to the existing attempts and bring further complexity in the market.

However, we strongly emphasise that full international harmonisation around a recognised sustainability reporting standard cannot become an end in itself. It should not deter or preclude jurisdictions with a higher level of ambition or a more ambitious timetable on sustainability reporting to achieve this, nor discourage private sector innovation. On the contrary, the most ambitious and advanced frameworks – such as the European one – should set the base for the international dialogue and be considered as a model to aspire to, with due regard for the peculiarities of the single jurisdictions. And ultimately the success of a sustainability reporting standard must be measured by whether the standard delivers the right information to make decisions to address sustainability challenges, and not only whether it is widely adopted. It should also monitor and bear in mind the quality of its implementation.

2. Is the development of a sustainability standards board (SSB) to operate under the governance structure of the IFRS Foundation an appropriate approach to achieving further consistency and global comparability in sustainability reporting?

The answer depends on the design of the SSB with regards to its mission, scope of work and governance.

Whenever new institutions are created, it is essential that the mission statement, scope of work and governance structure are well articulated and future proof. To meet that bar, the SSB mission should be to focus on financial as well as environmental and social materiality. It should commit to address sustainability in a holistic approach. And to ensure that the standards it develops are designed in the broad public interest, it should have transparent and clear decision-making processes where a diversity of stakeholder representation (public authorities, investors, preparers, civil society) is guaranteed. Sustainability reporting will increasingly touch on issues which are at the core of the political and societal discourse in democratic societies. The SSB may therefore be subject to much greater scrutiny in its decision-making than the IASB and therefore its decision-making process should be robust enough to ensure that its standards are accepted.

An SSB that from the onset focuses solely on financial materiality and climate-related issues will probably not achieve a global enough consensus to support its work. And the SSB will need to leverage probably a much more diversified expertise than the IASB due to the breadth and width of sustainability issues that are material.

Finally, to conclude, what would be undoubtedly beneficial is to have close collaboration between an adequately designed SSB and the IASB to ensure financial reporting and sustainability reporting becomes much more integrated.

3. Do you have any comment or suggested additions on the requirements for success as listed in paragraph 31 (including on the requirements for achieving a sufficient level of funding and achieving the appropriate level of technical expertise)?

We believe that all the factors identified by the IFRS are material to the success of the SSB. However, we would like to expand on "*achieving a sufficient level of global support from public authorities, global regulators and market stakeholders, including investors and preparers, in key markets;*" (Par. 31(a)). As mentioned earlier, we see two major challenges in achieving this sufficient level of global support. First, the SSB will need to reconcile different approaches in scope and materiality between jurisdictions with different level of ambitions and timetables. Second, unlike financial reporting, sustainability reporting is likely to come under much more intense political and societal scrutiny as it contributes to addressing growing sustainability challenges which are linked to the very sensitive issue of ensuring a socially just transition in the context of profound transitions of entire sectors of the economy to meet for example the 2050 goals of the Paris Climate Agreement. As a result, the SSB may from the start face a higher hurdle in achieving sufficient support and political accountability.

4. Could the IFRS Foundation use its relationships with stakeholders to aid the adoption and consistent application of SSB standards globally? If so, under what conditions?

We believe that the IFRS Foundation could use its experience, expertise and relationships acquired through its preeminent role in financial reporting to further advance sustainability reporting. However, that presumes the right choices are made for the SSB in terms of mission, scope and governance (see above).

5. How could the IFRS Foundation best build upon and work with the existing initiatives in sustainability reporting to achieve further global consistency?

We would encourage the IFRS Foundation to work closely with existing initiatives such as the Taskforce on Climate-Related Financial Disclosures (TCFD), existing sustainability standards setters such as the CDP, CDSB, GRI, IIRC and SASB.

We would encourage the IFRS foundation to liaise closely with the EFRAG that is currently developing an EU sustainability reporting standard at the request of the European Commission. At an inception phase, the SSB mission statement should also include a reference to the UN Sustainable Development Goals as a political commitment to developing sustainability reporting standards across the width of issues impacting the SDGs. This would strengthen SSB role and recognition at an international stage.

6. How could the IFRS Foundation best build upon and work with the existing jurisdictional initiatives to find a global solution for consistent sustainability reporting?

It is essential that the IFRS Foundation sets a realistic objective from the start, while ensuring the SSB is given a mission, scope of work and governance that is fit to the task of developing a globally consistent sustainability reporting framework.

As we noted earlier, it is unlikely that a fully harmonised and globally consistent can be achieved in light of the different stages of the process in which different jurisdictions find themselves. If the SSB however wants to achieve that, it is essential that it builds it approach on ‘double materiality’, with a broad holistic approach to sustainability and a transparent governance structure.

An approach that falls short of this would probably going to be less relevant for the EU, where the EFRAG has been mandated to examine the development of a European sustainability reporting standards building on double materiality and a broad approach to sustainability. In the EU context, such an approach is particularly relevant for investors and other market participants that will have to comply with regulatory frameworks such as the EU Taxonomy and the EU Sustainable Finance Disclosure Regulation (SFDR).

7. If the IFRS Foundation were to establish an SSB, should it initially develop climate-related financial disclosures before potentially broadening its remit into other areas of sustainability reporting?

We understand the rationale for the SSB to start with climate-related financial and sustainability disclosure. However, the SSB should combine it with a clear indication that they will have a holistic approach towards the areas of environmental, social and governance issues, which have become abundantly clear as an area of further work in the context of the COVID-19 pandemic. Where we do not want to end, is a situation where all the focus is on climate, with an absence of information on these other sustainability factors. Acknowledging that the measurement and reporting of climate factors is more advanced at the moment, SSB could start working at a different pace and level of detail in the three dimensions of sustainability. The fact that social issues are less advanced in terms of measuring and reporting means that more efforts should be put on this side. Moreover, since social topics touch those issues that can be relevant in the political and social public debate – and therefore have a national peculiarity – SSB could be an international Forum of debate around those issues in terms of reporting.

8. Should an SSB have a focused definition of climate-related risks or consider broader environmental factors?

As mentioned in previous answers, the mandate and scope of work for the SSB from the start should be broader and take a holistic view of sustainability. There is now overwhelming and undisputed scientific evidence emanating from reports such as the IPCC, that climate change and other sustainability issues such as biodiversity loss, air quality, use of water and pollution (soils, ocean, water) are interconnected through feedback loops reinforcing each other. Therefore, we would be opposed to an approach which seeks to prioritise and sequence sustainability objectives. We should not only seek to integrate financial and sustainability information, but we should also seek to connect sustainability information across different sustainability objectives.

9. Do you agree with the proposed approach to materiality in paragraph 50 that could be taken by the SSB?

Eurosif disagrees with the approach taken by the IFRS Foundation. We believe it is vital from the start to make clear that the scope and end goal of the SSB is to adhere to financial as well as environmental and social materiality ('double materiality'). Failing to clearly communicate this from the start could seriously undermine the acceptability and sufficient level of support from various actors that have been identified as key success factor (Q3).

Both concepts of materiality are reflected in existing standards. While constant work is needed to develop standards further, limiting it from the onset to financial materiality essentially means it will be less relevant for investors, market participants and stakeholders based in the EU.

10. Should the sustainability information to be disclosed be auditable or subject to external assurance? If not, what different types of assurance would be acceptable for the information disclosed to be reliable and decision-useful?

In general, we would support as far as possible subjecting the sustainability information and disclosure to auditing and assurances. If we want investors to start relying much more on this type of information to make investment decisions, then some form of third-party auditing and assurances would certainly facilitate that.

We need however to distinguish between different types of sustainability information. Backward-looking, historic sustainability information could be compiled and then be subjected to an assurance process that is similar to financial information. However, decision-useful information for investors will include also some forward-looking information such as corporate alignment with the output of various climate scenarios, and conversely the contemplated impact of these scenarios on corporate strategy and financials. Here, it seems very likely that it will not be possible to provide the same level of assurances around the accuracy of the information. However, partial assurances could be given around the robustness and integrity of the process to identify and define the specific impact of such global external scenarios on the company, and the alignment of company's strategy with such scenarios (or its contribution to making such a scenario materialise).

11. Stakeholders are welcome to raise any other comment or relevant matters for our consideration.

ABOUT EUROSIF

Eurosif is the leading European association for the promotion and advancement of sustainable and responsible investment making a measurable impact in meeting long-term sustainability goals of the EU and the UN.

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