GLOBAL ESG REPORTING STANDARDS: CONSISTENCY AND GREENWASHING RISKS

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The ISSB should provide a comprehensive baseline to ensure a level-playing field

As highlighted by the outcome of the public consultations run by the European Commission and the IFRS Foundation prior to their recent disclosure initiatives, there is a strong demand from investors, public authorities, regulators and civil society for high-quality information from businesses about environment, social and governance (ESG) matters. This information is crucial to assess the extent to which companies are exposed to ESG risks and to hold executives accountable for the ESG impacts of their companies' activities.

Indeed, similarly to financial risks, ESG issues have global implications that require policy coordination at a global level. In this respect, all Member States of the United Nations have pledged their support for the Sustainable Development Goals. However, in order to ensure consistency in policy implementation worldwide, it is critical that jurisdictions further agree on a common language to describe and measure ESG risks and impacts. We must hence aim at a minimum set of highly comparable international key ESG metrics.

Failure to coordinate a coherent international ESG disclosure framework would result in the multiplication of competing regional initiatives, leading to fragmented disclosure requirements. Comparability across reporting standards is required to avert the risks of greenwashing and confusion for the users of ESG data, including consumers, investors, NGOs and scientists. Fragmentation could also raise level-playing field issues across jurisdictions and increase the red tape for international companies.

Therefore, we support the initiative from the IFRS Foundation to provide a global baseline for high-quality ESG disclosure requirement and strongly encourage the International Sustainability Standard Board (ISSB) to pursue swiftly an ambitious standard-setting agenda covering all ESG dimensions with a building-block approach. One of the main expected challenges to build minimum consistency globally stems from the risk that the ISSB may lag behind the expectations from some jurisdictions that are adopting ambitious action plans in order to promote sustainable growth. The building-block approach will however enable policymakers to add complementary components to the baseline without harming comparability.

It is critical that jurisdictions agree on a common language to disclose ESG risks and impacts.

Meanwhile, we also support the work undertaken by the European Financial Reporting Advisory Group (EFRAG) to devise European Sustainability Reporting Standards consistent with the international baseline set out by the ISSB. These standards will provide the additional disclosures necessary to achieve the specific policy objectives laid down in the European Commission's Sustainable Finance Strategy. Even if its own strategy is more ambitious, the European Union is committed towards a global disclosure framework and remains the first contributor to the IFRS Foundation's voluntary funding scheme.

Another hurdle to overcome is the materiality assessment that companies are required to carry out in order to determine which information is relevant to their stakeholders and, consequently, should be disclosed. While in some jurisdictions (e.g. US), materiality assessment may be anchored in the legal framework and subject to judicial scrutiny, leaving little room for a globally harmonised approach, from our standpoint, it is however critical to stick to a double materiality perspective encompassing the impacts of economic activities on the environment and the people.

There is no miracle recipe to ensure international convergence as the latter rests on extensive engagement to reach a shared and mutual understanding.

The standards issued by the ISSB should become the global common baseline while providing the flexibility to implement complementary disclosure requirements essential to meet local policy needs. The baseline should however be comprehensive enough to ensure a level-playing field globally and circumvent the risks of dumping. Issues such as gender equality, environmental preservation or the rights of ethnic minorities are just as relevant all-over-the-world as they are in Europe. ESG standards are not superfluous as they ensure human dignity and fairness worldwide.

Let us also keep in mind that high quality disclosure standards should go along robust enforcement mechanisms in order to ensure that disclosures are reliable, exhaustive and understandable. In that regard, ESG and financial information should be put on an equal footing. ESG information ought to be audited and the governance bodies and management should be held liable for failure to publish comprehensive and accurate information. In addition, the mandate of securities market, banking and insurance supervisors could be broadened to monitor the consistent implementation of the standards. Finally, a key feature of success will be that the standard-setting bodies including the ISSB and EFRAG establish and maintain the appropriate fora to discuss interpretation issues arising from the implementation of their standards.

CYRIL ROUX
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ESG standards are an issue of sovereignty for Europe

To define ESG standards is to define corporate standards of conduct. Different polities will have different expectations for the firms operating in their jurisdictions. Let's take a few examples. Corporate social responsibility, embedded in the S of ESG, encompasses workforce composition. Some aspects of this may be settled, such as gender equality. Other aspects are more fraught however, such as race equality. In the USA, it can be measured and reported, as people are used to declare their race or ethnicity. And race equality in the workforce can be increased numerically through affirmative action. In France by contrast racial statistics are outlawed, and affirmative action goes against constitutional principles. So French firms will be hard pressed to quantify the degree of racial equality in their workforce as measured by American standards. The World Economic Forum suggests measuring diversity or participation of lower represented groups, leaving open the specifics, and shying away from mentioning race or ethnicity explicitly. This may be wise indeed.

Other issues of social responsibility are just as vexed. It's easy in principle to condemn firms working in countries trampling on human rights or sponsoring terrorism, but it is unlikely that we will agree on the list of those countries. Certainly, the lists drawn in Washington, Brussels, Beijing, Pretoria and Abu Dhabi will very much differ. There is scope to sidestep the widest differences on the blacklisted jurisdictions by concentrating on child and forced labor, and conviction for corruptions, but only to a degree. So, the difficulty in agreeing on corporate responsibility standards in this instance, and quite a few others, is not primarily a measurement problem, nor an issue of data availability, or a question of engineering the right metrics. It is first and foremost an issue of politics and civilization.

My last instance will be the most openly and fiercely debated of the last few months. Energy production and consumption is at the heart of sustainability. Finding common ground on which sources of energy should be used by responsible firms is paramount for the whole ESG project. But in this instance even intra-regional differences are stark. Europe is severely torn between countries which tout nuclear energy as part of the solution to climate change, and those countries that would rather use local coal, or accept dependency on the fossil fuels of foreign regimes for decades to come, than put European people at risk of another Chernobyl or Fukushima.

The European Union must define its own ESG standards.

Most Frenchmen would find no issue with the metrics around carbon or emission of GHG. But as the EU debate on taxonomy makes clear, finding common ground what is and what isn't green energy will be hard enough within Europe. Certainly, a world where French industries would show poor regional or global ESG metrics because of their use of nuclear-based electricity is unlikely to be accepted by French authorities.

In addressing the difference in views on what constitute proper corporate behavior, we may choose the lowest common denominator in order to define global standards. There is very good work done in this spirit by the World Economic Forum. This would not preclude additional, more stringent or more specific rules on a regional basis. Alternatively, we may choose to recognize as equivalent several regional standards. This would recognize that there are optimal areas for agreement on specific standards, in the same way that there are optimal currency areas, and that the globe is too wide and diverse to be one in itself. What I think the European Union must not do is to abdicate its worldview and adopt purported global standards at odds with it, or worse still, flag its intention to adopt yet unspecified standards. Sovereign countries such as the USA or China will not do so; the European Union must be as resolute in asserting its values, in defining what it expects or require from European companies, and not relinquish its sovereignty on the matter.

The adoption of global standards sight unseen is either naïve or fatalist. It would be the course of action most likely to leave Europe as the sole region not making its own corporate rules. There is more than enough contestation of democratic deficit already in Europe to worsen the situation in this manner.

A last word of caution is needed about the interplay between this debate and international trade. The European Union can no longer expect the ratification by European member states of bilateral trade agreements with countries in which companies behave in a way unsanctioned in the EU. European citizens no longer accept trade agreements opening the single market to foreign firms which contribute to deforestation, release massive amounts of GHG, or follow health and safety standards way below those imposed on European firms. It would be wise for EU representatives to keep this is mind when negotiating the international architecture of ESG standards.

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Towards interoperability of sustainability reporting frameworks

The Corporate Sustainability Reporting Directive (CSRD) proposal aims to improve sustainability information disclosed by corporates. It takes a comprehensive approach, including a wider coverage of companies than is currently the case, the introduction of an assurance requirement, and the digitalisation of sustainability information. The centrepiece of the proposal, however, is the introduction of mandatory EU sustainability reporting standards.

EU standards must be coherent with the EU's political ambitions and with our existing framework for sustainable finance. From the onset, EU standards will cover all ESG topics, including but not limited to climate, under both materiality perspectives: how sustainability issues create risks and opportunities for the company, and an objective account of the company's own impacts on people and the environment. To ensure coherence with the EU legal framework the information companies report must be aligned with the information investors need under the EU's Taxonomy Regulation and the Sustainable Finance Disclosure Regulation. From a financial markets perspective, investors increasingly need sustainability information. Ambitious sustainability reporting frameworks will ensure that companies listed in the EU disclose all material information that investors need. We expect similar trends in investor expectations in capital markets across the world. Europe is leading the way on many of these issues – but we know we cannot do it alone, which is why we continue to place a high priority on our cooperation with global partners.

Companies need to be encouraged to switch corporate decision-making to a more long-term and stakeholder oriented, "sustainability mind-set", starting at the strategic level. We need to increase transparency in the market place about the sustainability performance of companies including via additional reporting requirements. Such transparency will allow companies to signal their transition efforts to investors.

We will build on what exists seeking in principle global alignment while meeting EU's specific needs.

The Commission strongly welcomes efforts to create more alignment of ESG reporting standards at global level. The Commission supports the IFRS Foundation's plans to create a global baseline of sustainability reporting standards under the recently established International Sustainability Standard Board (ISSB). The ISSB standards should be a useful foundation on which we can build according to the EU's ambitious political priorities and legal framework.

The Commission is also closely looking at ESG reporting frameworks being developed in other jurisdictions. The US Securities and Exchange Commission (US SEC), for example, is currently working on a proposal on disclosure rules on climate and some other issues.

Cooperation between global and regional standards-setters is key to assure coherence and interoperability between reporting frameworks. We welcome the fact that the International Financial Reporting Standards Foundation (IFRS Foundation) is considering mechanisms for how the ISSB will interact with standard-setters at jurisdictional level. In charge of developing draft sustainability reporting standards, the European Financial Reporting Advisory Group (EFRAG) has already established close technical cooperation with the IFRS Foundation. Overall, we see global and jurisdictional interaction as a two-way process. EFRAG has put forward the concept of "co-construction" to describe this.

The EFRAG Project Task Force on EU standards has signed Statements of Cooperation with the Global Reporting Initiative, and with Shift, one of the leading authorities on the UN Guiding Principles on Business and Human Rights. EFRAG is also considering the disclosures originally developed by the Sustainability Accounting Standards Board (SASB).

There is already a lot of common ground for global coherence on sustainability reporting. For example, the CSRD proposal incorporates all the key elements of the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations and the work of the ISSB and the US SEC are also likely to refer to the TCFD Framework.

We also consider that an equivalence system may be a useful tool. The CSRD proposal envisages the possibility of granting equivalence to the sustainability reporting rules of other countries. The equivalence system would be developed by the Commission in due time, once the CSRD proposal becomes law, but it is clear that there has to be an appropriate level of convergence of measures and ambitions to deliver an equivalence system.

The European Commission fully supports the goal of greater global alignment of sustainability reporting standards. It will build on them and seek as much global alignment as possible. However, global standards should be a common floor, not a ceiling. They should be flexible enough to accommodate the need for different jurisdictions to go further and faster according to their own priorities.

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Consistent disclosure standards are critical to mobilising ESG finance

The message from 2021 is that we need to take urgent action to prevent further irreversible damage to our environment. The cost of action is outweighed by the cost of inaction, in terms of the impact to our economies, societies and households.

Despite encouraging progress and growing climate ambition laid out at COP26 in Glasgow last November, we need greater sustainable investment to deliver the goals of the Paris Agreement and more broadly the UN's Sustainable Development Goals (SDGs). This is particularly true for emerging markets, which continue to face growing shortfalls in the private capital needed to meet their investment needs.

Disclosures are a critical tool in scaling investment in the fight against climate change and the delivery of sustainable development globally. They allow the pricing of externalities, such as greenhouse gas emissions. They facilitate the effective allocation of capital and more informed decision-making in terms of strategy and risk management to achieve more sustainable, long-term growth. In this sense, disclosures are not just about transparency, they are transformational.

This potential is recognised in both the public and private sectors.

Our Zeronomics report (https://www.sc.com/en/insights/zeronomics/) found that 81% of senior managers from both multinationals and large domestic corporates believe standardised, globally consistent measurement and reporting standards would help accelerate their net zero plans. High-quality, comparable, and reliable data enhances the assessment of sustainability-related risks and opportunities. Furthermore, it provides a common language to measure and report on society's progress towards sustainability.

In the public sector, policymakers globally are active in developing these standards. However, in October 2021 the G20 Sustainable Finance Working Group roadmap stressed the challenge of inconsistent and fragmented sustainability-related disclosures and highlighted the need to improve international coordination.

Disclosures are not just about transparency, they are transformational.

To achieve this, COP26 saw the official launch of the IFRS Foundation's International Sustainability Standard Board (ISSB). We support its building blocks approach, aimed at providing a global sustainability reporting baseline while providing coordination on additional jurisdictional reporting requirements. This promotes greater comparability and consistency. Some degree of flexibility alongside a global standard is understandable, particularly for social and governance factors of 'ESG' which are context and location specific.

But the global standard needs to form the baseline.

As a bank operating in around 60 markets, we are used to a certain amount of divergence across jurisdictions. Regulatory-driven fragmentation, however, needs to be avoided as it risks hampering the rapid scaling of sustainable investment and the channelling of capital to where it is needed most. It forms barriers to market entry, confuses those who actually use the data and disclosures, and damages the attractiveness of the market.

The solution is proportionate regulation and better international cooperation. Coordination should focus on the development of common principles that promote interoperable standards, which can be applied across all jurisdictions while providing for the different transition trajectories toward net zero of individual markets. Such an approach would support standardisation by defining key metrics, while its associated variation in threshold levels would help address regional heterogeneity in green qualification and reduce the risk of greenwashing.

We are committed to ensuring sustainable capital reaches the regions where it is needed the most. COP26 showcased the extraordinary support from the private sector, and its importance in creating the enabling policy to reach this goal. I am proud to chair the Net Zero Banking Alliance, which is promoting standardised approaches and shared tools for transition across the banking sector, and Standard Chartered published its own net zero strategy last year [https://www.sc.com/en/sustainability/net-zero/].

The unprecedented effort of the financial sector in helping the world transition needs to be supported by enabling policies that facilitate and incentivise cross-border finance, in addition to managing risk and ensuring stakeholder transparency. Let us build together a framework that allows the financial sector to support the transition not only in developed markets, but globally. Otherwise, we will fall a long way short of what is needed.

EMMA CRYSTAL

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Consistent ESG disclosure is required to advance the transition agenda

The scale, complexity and urgency required to tackle the climate and nature crises demand unprecedented global action. Addressing these challenges and delivering more generally on the UN Sustainable Development Goals to enable human well-being will involve renewable energy, infrastructure investment, sustainable agriculture, ecosystem restoration, and many other innovative measures. In this context, regulatory fragmentation in sustainable finance policy appears as a key risk and potential impediment to the development of innovative and scalable solutions. Moreover, the lack of consistent, comparable, and quality data on sustainability factors is a major hindrance to advancing the sustainable finance agenda and as a result the transition to Net Zero.

We believe that ESG disclosure requirements are a fundamental enabling and supporting tool in the race to Net Zero. However, for this tool to deliver its full potential, ESG disclosures should be internationally aligned, built on existing standards (e.g., TCFD, GRI, SASB), and applied to financial and non-financial participants alike, to provide investors and the public with the required transparency to efficiently guide investment decisions towards the transition to a low-carbon economy and prevent greenwashing. Accordingly, we strongly support the International Sustainability Standards Board (ISSB) developing a comprehensive global baseline of sustainability-related disclosure standards and welcome EFRAG's commitment to working with the ISSB to 'co-construct' those standards.

While each country, firm, investor, and individual understandably pursues its own sustainability journey, to have a common language in sustainable finance would be an invaluable help to make the sustainable finance market more transparent and channel capital more efficiently into sustainable investments. Today, the proliferation of ESG reporting frameworks across the globe, though being a clear signal of progress and interest in the field of sustainability, threatens to overwhelm investors and reporters. As a financial institution operating globally, we are facing various mandatory ESG disclosure requirements in different jurisdictions, reflecting local specificities and policy priorities, and necessitating the mobilization of substantial resources to ensure compliance.

Clarity and transparency, both at firm and product-level, are crucial for investors and the public.

The complexity of having to establish tailored ESG reporting systems for each jurisdiction risks being further exacerbated if jurisdictions develop rules with extraterritorial application as is the case with the EU Corporate Sustainability Reporting Directive (CSRD) proposal. We are concerned by the extraterritorial reach of the CSRD, which would require many non-EU financial institutions to comply with the EU sustainability reporting requirements at the level of their group consolidated reporting for their entire portfolio across the group operations, including in third countries.

Beyond the practical and operational challenges of complying with the CSRD and related EU Taxonomy disclosures with respect to activities and exposures outside the EU, this extraterritorial approach would require international firms to produce several consolidated sustainability reports according to different sets of rules; thus, increasing the complexity of transparency towards end-investors who will have to consider several sustainability reports for the same issuer. We therefore hope to see the rapid development and establishment of the ISSB Sustainability Disclosure Standards, which should allow jurisdictions to defer to other countries' disclosures if they are aligned with those standards.

To navigate the increasingly complex sustainable investment landscape, clarity and transparency, both at firm and product-level, are crucial for investors and the public. With this in view, we believe that sustainable finance rules and regulations should be aligned to the greatest extent possible, including the development of taxonomies for the classification on sustainable economic activities. Moreover, it is important to ensure that ESG ratings providers are subject to appropriate oversight and harmonized requirements to improve the transparency of the methodologies, information and assumptions they use, which are currently lacking consistency and leading to disparate ratings. Wherever possible, we prefer the selection of measurable KPIs as opposed to more subjective expert-based assessments which may vary from one ESG rating provider to the other.

In this respect we welcome the recent IOSCO recommendations for ESG ratings and data products providers as a step in the right direction to improve the quality and transparency of ESG ratings, which are widely used to evaluate the sustainability of assets and to value the products and sectors that orbit the growing ESG investing space.