Converging globally on sustainability standards

Introduction

The Chair welcomed everyone to the session on sustainability reporting standards. This year has seen the first two inaugural standards of the International Sustainability Standards Board (ISSB), the adoption by the European Commission of the European Sustainability Reporting Standards (ESRS) adopted by the European Commission on 31 July based on EFRAG's technical advice, and the endorsement of the G20/OECD Principles of Corporate Governance at the G20 leaders' summit. In September the Taskforce on Nature-related Financial Disclosures (TNFD) will issue its framework.

1. The Reception of the ISSB standards and of the EU standards (ESRS)

A standard setter stated that the ISSB package of standards comprised of S1, a general requirement to report risk and opportunities relating to material sustainability matters, and S2, direct disclosures on risks and opportunities regarding climate. The ISSB has been set up as a response to global demand, so the response from the global investor community has been supportive. After the release of S1 and S2, the Financial Stability Board (FSB) determined that its work on the Taskforce on Climate-related Financial Disclosures (TCFD) and monitoring of disclosures would pass to the ISSB. In July the International Organization of Securities Commissions (IOSCO) provided an endorsement of S1 and S2, which will form a global baseline of reporting for IOSCO membership.

The Chair noted that the speed with which IOSCO has endorsed the standards is a strong message.

A standard setter stated that the Corporate Sustainability Reporting Directive (CSRD) has been adopted on 31 July 2023 by the European Commission and that the process has been very consistent. The content's depth has been adjusted to incorporate the feedback received during the consultation. The mandate dictates that significant impacts, risks, and opportunities must be reported using a dual-materiality approach. A comprehensive system involving a legal framework with robust standards, appropriate governance, implementation of materiality, auditors, and stakeholders is expected to ensure a high level of quality.

The European Commission noted that additional phase-ins and an extension of the materiality assessment was aimed at reducing possible costs. A cost-benefit analysis made by CEPS for EFRAG estimates the cost for companies subject to sustainability reporting for the first time would be around 0.013% of their turnover. In the long term, it is clear that the benefits will outweigh the costs.

An official stated that Switzerland is a very strong supporter of the ISSB and its global baseline standard because it is based on the TCFD recommendations. There is room for non-EU members to be compliant, so Switzerland decided to integrate TCFD early on. A TCFD-based regulation stipulating mandatory disclosure will come into effect in January 2024. Companies are free to choose the details of how to report, as long as it is compliant with the TCFD recommendations and the minimum requirements set out in the regulation, and are free to integrate ISSB elements into their reporting. There will be a review after three years and the next stage will address how to deal with the ISSB standard.

As a small jurisdiction, Switzerland is mindful of comparability when planning to achieve climate-related goals. In addressing small- and medium-sized enterprises (SMEs), Switzerland is working on the assumption of an equivalence with the EU. There is engagement in the Net-Zero Data Public Utility Facility that supports comparability of data and also in the Sustainability Standards Advisory Forum.

1.1 The US regulation agenda

The Chair sought an update on the US regulatory agenda and potential alignment with the ISSB and European standards. An industry representative stated that Bank of America supports the convergence and efforts to achieve transparent, comparable, and consistent disclosure requirements. The more reliable and comparable the data is the more investors will be informed to make the right decisions and banks to deploy capital where it is needed.

It is not clear what the Securities and Exchange Commission (SEC)'s final rules will be when they are issued in October, but Bank of America believes jurisdictions should work together to find a somewhat uniform approach at international level when it comes to disclosure. The US is contemplating just climate disclosures for the time being and achieving convergence in this area would be a good outcome. In the US the legal culture is very different in nature to that of Europe with a higher incidence of litigation. The SEC should take into account that data quality will be poor for some time, so targets should not be set in stone.

1.2 The Taskforce for Nature-related Financial Disclosures (TNFD)

An industry representative stated that the TNFD is trying to emulate the TCFD and will also be built around four pillars of governance strategy, risk management, metrics, and targets. The TNFD will be neutral in terms of its materiality approach and a company can explain whether they will report under single materiality or double materiality. The TNFD will be explicit that organisations should start reporting where they can and commit to expanding over time. The Chair understood that the TNFD will offer a baseline, which is already consistent with other approaches.

2. The implementation challenges of the sustainable reporting standards

An industry representative stated that the ISSB standards are seen as the global baseline for sustainability reporting. Although the ISSB and ESRS are broadly compatible further work will be needed to iron out the differences between ISSB and European guidance. Bank of America is subject to CSRD, starting in 2025 for the main EU-based entities and 2029 for the US. The European Commission has simplified the standard, which is an improvement, but hurdles to implementation remain, in particular the lack of reliable data, materiality assessment, and comparability of reporting between big and small entities, which cannot be achieved immediately.

The poor data quality means we can expect inconsistent disclosure practices which can result in different results for similar entities. This could impact comparability and the reputation of the standards. If conclusions are inconsistent this will be a real problem for the market and the investors. The European Commission and EFRAG should set up an interpretation forum to give clear guidance on the flexibility of implementation.

The Chair asked whether the standard setters could address some of the concerns. An industry representative stated that ideally there will be a single set of uniform standards and clear guidelines so that elements that are unclear can be interpreted.

2.1 The response of the standard-setters to the call to support the implementation of the standards

A standard setter stated that COP27 will work on the capacity building with partners. The IFRS Foundation will play a strong leadership role in terms of capacity building and implementation guidance. A knowledge hub will be launched. The document A Journey to Adoption of S1 and S2 gives a sense of the transitional provisions provided by the IFRS foundation and this will be enhanced by an adoption guide.

A jurisdictional working group will be formed to share experiences. Advanced work with the European Union, EFRAG and the European Commission will bring together the S2 and EU requirements on climate. The Foundation and the European Union have recently commented on the strong level of interoperability leading to a minimisation of any sort of double reporting. Asked whether the IFRS Foundation had the capacity to respond to requests for technical assistance, a standard setter explained that this would take place via the knowledge hub and that the work to provide responses will be split between the European Commission and EFRAG.

The Chair asked whether further guidance can be issued to help with the implementation and quality of data, given the concerns that the quality of the first reports will be low and that this could undermine the credibility of the system. A standard setter understood the challenges but would not call them concerns. The 2002-2005 transition to IFRS was deemed almost impossible in the EU, but it was achieved with discipline and success. There is a need to facilitate the capacity of users to analyse and the key element is a simplified mandatory regime.

The balance that has been struck is reasonable, with the phase-in being key points. EFRAG and the European Commission aim to contribute to the global progress of sustainability reporting and avoid multiple reporting. EFRAG is strongly in favour of a single report and due to the efforts on both sides, 99.1% interoperability has been achieved. ESRS incorporates ISSB disclosure points on climate. EFRAG's joint statement with the Global Reporting Initiative (GRI) acknowledges a high level of interoperability, which means that companies reporting on their ESRS in the EU will also be deemed to report with reference to GRI. All of these should be translated into the digital format and an access point will be opened for questions.

The ESRS is also consistent with the Sustainable Finance Disclosure Regulation (SFDR) or the Pillar 3 indicators. Going forward, there will be a SMEs standard, on a voluntary basis to ensure SMEs are not excluded when asked to provide regional data to large companies.

The Chair noted the challenge on the auditing side where it is expected that auditors audit to the reporting standard but also check the materiality assessment of the companies.

In terms of key challenges for assurance reviews, the European Commission noted that audit and assurance is a very important element of the framework, because it is important that the information that is disclosed is reliable. Auditors and other assurance providers can be called to exercise this power and issue an opinion, but one challenge will be that it is not yet known whether the markets or providers are available and to what extent auditors have the knowledge to produce opinions in a new area. The system allows member states to introduce different auditors for financial statements and assurance providers for sustainability reporting, so the interaction between those two assurers will have to be taken into account.

The support from EFRAG will concentrate on guidance concerning the materiality assessment. The audit and assurance side will need some published guidance and the Commission intends to help with a portal where questions can be collected and answered. Such guidance will be essential to support companies with this new exercise.

2.2 The implementation challenges of the TFND framework

The Chair asked for a view on the disclosure of nature-related financial risks and the implementation challenges to the TNFD. An official supported nature-related aspects. Switzerland is supporting the TNFD work from a financial perspective and has established a national consultation group where companies can familiarise themselves with the framework. The TNFD should be a firm basis for the development of a standard.

An industry representative agreed that biodiversity should be the priority for the next project for the ISSB. Most people are saying that implementation should be the focus of the ISSB, which will actually be done by the national or European standard setters and supervisors. This will be the SEC in the US, the EFRAG and Commission in the European Union, and the Sustainability Standards Board of Japan (SSBJ) and the Financial Standards Agency (JFSA) in Japan.

The ISSB should let the regional and national regulators carry out the work. There can be coordination later, if needed, but currently the focus should be on the new project because it is only the ISSB that can provide the global baseline. The ESRS and the ISSB S1 and S2 are not entirely aligned, so the ISSB should focus on filling in those gaps and work on implementation later.

Conclusion

The Chair thanked the panel for their excellent contributions. It was recommended that the community learns from the experience of the implementation of the first IFRS standards in the 1970s and not let it take 30 years to reach convergence on these standards, although it is a huge change. The third parties on the OECD side are interested in gaining the data and want companies to produce this as soon as possible, although the goal of consistent, comparable data will require huge, costly, and timely transformations. It will happen very quickly this time.