IFRS Foundation Consultation Paper on Sustainability Reporting

UK Finance response

24 December 2020

Introduction

UK Finance is the collective voice for the banking and finance industry operating within the UK. Representing more than 250 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

We have already put on record our support in principle for the development of a global framework for sustainability reporting in a white paper on multi-year commitments to sustainable finance[1] published last month. In this we welcomed the UK government's support for the IFRS Foundation consultation made as part of the Green Horizon Summit. We also referenced the World Economic Forum (WEF) report on global environmental, social and governance standards (ESG)[2] noting that this builds upon the statement by five leading international sustainability standard setters that they intend to work towards a comprehensive corporate reporting system[3].

This is in addition to the European Commission revising its Non-Financial Reporting Directive (NFRD), the International Organization of Securities Commissions (IOSCO) committing to accelerate the harmonisation of sustainability standards and the US Securities and Exchange Commission (SEC) amending its rules to advance human capital disclosures.

The IFRS Foundation consultation also comes at a time when over 1600 organisations from over 70 countries have committed to act upon the recommendations of the Financial Stability Board (FSB)-sponsored Task Force on Climate-related Financial Disclosures (TCFD).

There is also a substantial wealth of sustainability-related material available from the United Nations (UN), not least in the form of the Sustainable Development Goals (SDGs), but also initiatives on the part of the UN Environment Programme Finance Initiative (UNEP FI) such as the Principles for Responsible Investment and the Principles for Responsible Banking and further developmental work in support of TCFD implementation by financial institutions and in support of the EU green taxonomy.

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[1] UK Finance white paper *'Sustainable finance: a principles-based framework for the measurement and reporting of multi-year commitments', November 2020*

[2] WEF IBC report 'Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation, 22 September 2020

[3] Statement of Intent to Work Together Towards Comprehensive Corporate Reporting', CDP, DCSB, GRI, IIRC and SASB, September 2020.

In addition to this many countries have primary legislation setting out directors' duties in support of their acting in the long-term interests of the company, key aspects of human rights and other legislative provisions relevant to aspects of stakeholder interests, whether in respect of customers, employees or the wider community, relevant provisions within financial regulation – particularly in respect of climate – and corporate governance requirements which in some cases have substantially transformed the quality of strategic reporting in recent years.

This illustrates the extent to which standard setters, intergovernmental bodies, regulatory authorities and others within the marketplace have made significant steps towards improving the quality of sustainability reporting. This however remains patchwork and incomplete.

We therefore see substantial benefit in the establishment of a Sustainability Standards Board (SSB) that would seek to bring into a unifying structure the varying approaches that have developed across the globe and consider the IFRS Foundation to be a highly suitable guardian in which to entrust the task of drawing together global and regional ESG reporting standards to achieve global harmonisation.

We view the Covid-19 crisis as providing a backdrop in which a high degree of consensus has emerged in favour of environmental and social factors being built into economic recovery measures as we look to 'build back better'. By looking to capitalise on work already undertaken by others – with their consent and cooperation - the SSB should encounter a tailwind enabling relatively rapid progress to be made.

We next turn to the specific questions raised in the consultation.

Questions for consultation

Question 1: Is there a need for a global set of internationally recognised sustainability reporting standards? (a) If yes, should the IFRS Foundation play a role in setting these standards and expand its standard-setting activities into these areas? (b) If not, what approach should be adopted.

UK Finance sees a strong case for a global set of internationally recognised sustainability reporting standards and view the IFRS Foundation as being uniquely placed to bring this into effect in a timely and efficient way. The IFRS Foundation has demonstrated its ability to set global standards for financial reporting, growing from strength to strength in the past decade, and is in a good position to emulate its success in setting sustainability reporting standards. This will be dependent upon the Foundation building upon the better aspects of its experience in establishing the recognition of international financial reporting standards. Key to success will be the ability of the Foundation to work collaboratively not only with current standard setters, but the full complement of stakeholders that are increasingly placing weight on sustainability factors as important drivers of long-term corporate value. In addition, the IFRS Foundation needs to engage in a scoping exercise to properly assess the current sustainability landscape and identity areas where it can contribute and add value.

Question 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?

Yes. There is a very real distinction between financial and non-financial reporting and so we consider that sustainability should be set up as a parallel workstream to the setting of international financial reporting standards. While there is a clear interrelationship between the two, there are also important distinguishing features. Sustainability issues need to be considered in their own right and by reference to differing sources of information and expertise, within a conceptual framework aimed at enhancing internal consistency both within and between financial and non-financial reporting.

Question 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 view the requirements for success as listed in paragraph 31 of the consultation and included as representing precisely the right factors in determining that the IFRS Foundation acquires the legitimacy needed in order for it to assume global responsibility for setting sustainability reporting standards. While it will be important to establish the right governance structure, technical expertise and level of funding, achieving global support from public authorities, global regulators and market stakeholders, and working with regional initiatives, will be key to the establishment of a global framework for sustainability reporting and the pace at which this can be put in place – making the critical difference in terms of the progress that can be made in the short to medium term. Adopting a value-added approach in which the SSB builds upon pre-existing initiatives should also be beneficial from a funding perspective.

We further agree with the way in which relationships with other institutions and initiatives is set out in paragraphs 32-36 of the consultation, including the call out for the TCFD and the commitment made by five currently existing ESG standard setting bodies to cooperate in the development of a coherent and comprehensive corporate reporting system.

In terms of the TCFD, it speaks volumes that over 1600 organisations from over 70 countries have committed to act upon its recommendations and these have been made centre piece within certain regional and national statutory and regulatory approaches. We would therefore say that the TCFD can be cited as a prime example of what can be achieved through cooperation between government, regulators and market players. The SSB should seek to be guided by the dynamic this has generated, also drawing upon the best of existing approaches.

The SSB will also wish to make use of a wealth of sustainability-related material available from the United Nations (UN), not least in the form of the Sustainable Development Goals (SDGs), but also sector-specific initiatives on the part of the UN Environment Programme Finance Initiative (UNEP FI) such as the Principles for Responsible Investment and the Principles for Responsible Banking and further developmental work in support of TCFD implementation by financial institutions and in support of the EU green taxonomy.

This is in addition to many countries now having primary legislation setting out directors' duties in support of their acting in the long-term interests of the company, key aspects of human rights and other legislative provisions relevant to aspects of stakeholder interests, whether in terms of customers, employees or the wider community, relevant provisions within financial regulation – particularly in respect of climate risk – and corporate governance

requirements which in some cases have substantially transformed the quality of strategic reporting in recent years.

A further example of a market-based sustainability initiative would be the Poseidon Principles, under which global shipping banks, leading industry players and key experts worked together on integrating climate considerations into lending decisions to make them compatible with international shipping's decarbonisation.

There are also a series of frameworks or principles drawn up within the marketplace that have become the defining standard for the issuance of sustainability-related financial instruments at least on a regional basis, with prime examples being the ICMA Green, Social and Sustainability Bond Principles and the Loan Markets Association (LMA) Green Loan Principles. Appendix D of the UK Finance *white paper* referenced above provides a summary of some of these.

Also of relevance is the work undertaken by the Organisation for Economic Co-operation and Development (OECD) on responsible business conduct due diligence and separate international cooperation to counter money laundering and other forms of organised economic crime.

Question 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 view the utilisation of the relationships held by the IFRS Foundation with stakeholders as a pre-requisite to the adoption and consistent application of SSB standards globally. The SSB in its early days should undertake a comprehensive mapping exercise to ensure that it is fully cognisant of relevant governmental, regulatory, standard setting and market approaches that can both benefit from the introduction of a global framework for sustainability standards and contribute to its design. In addition, the IFRS should remain mindful of the current accounting differences across different regions and collaborate with other accounting authorities, notably FASB, that may impact the measurement, recognition and disclosure of sustainability-related matters.

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

The *modus operandi* of the SSB will be important. Rather than adopting an approach premised upon originating content, the SSB should seek to utilise and draw from the approaches and frameworks of the extensive network of stakeholder initiatives referenced in the consultation and this and other comment letters. The starting point therefore should be a comprehensive review of the existing frameworks, and their foundations, how they fit together, overlap and underlap. This will add to the credibility and effectiveness of the SSB and ensure that the global framework builds upon the progress made in recent years.

Question 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?

An appreciation of the point of departure will be just as important as the destination if the IFRS Foundation is to ensure that its framework works with the grain of existing initiatives

and genuinely augments steps already being made to improve the prioritisation of ESG aspects of economic activity. It is encouraging therefore to see that the International Accounting Standards Board (IASB) is already a member of the Corporate Reporting Dialogue (CRD) given its mission to strengthen cooperation, coordination and alignment amongst standard setters and framework developers. The relevance for sustainability reporting is evident.

Prior to commencing any work on developing yet another framework, the SSB should fully understand how existing frameworks fit together. This will ensure the SSB's contribution is credible and effective. After evaluating the current sustainability standard landscape and understanding existing challenges from current market participants, the SSB can identify where and how it can add value; whether in terms of adding coherence, filling gaps or reducing unnecessary and potentially conflicting overlap.

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

We see logic in the SSB prioritising climate-related disclosures before turning its attention more fully to other areas of sustainability reporting. This said, there are many resources that the SSB will be able to draw upon – not least the TCFD, material prepared in support of the implementation of its recommendations and ongoing governmental and regulatory support. The trick therefore will be to establish the value add that can be provided by the SSB bringing a measure of unified, global governance to the process of establishing climate-related disclosures.

While it should not seek to address broader sustainability issues in the first instance, the IFRS Foundation should nevertheless scope the SSB appropriately from the outset, to ensure sustainability standards are developed soon after climate-related disclosures, making full use of the current momentum within stakeholders to progress the sustainability agenda.

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

As per our response to question 7 above, the SSB needs to address the fuller suite of ESG factors that it wishes to be reflected in sustainability reporting. In case not self-evident, we would further add that even when focusing upon climate-risk, it is important to consider the broader environmental and social backdrop. As much of the existing material reflects, the transition to a low carbon economy involves not only an appreciation of 'climate' or 'climate-related' risks, but the strategy needed to fund innovation (in addition to simply de-risking), the benefit of building in broader environmental factors – including those relating to resilience – and the additional consideration of social factors, whether in terms of jobs and the investment needed for reskilling or the effects of the net zero transition on households and local communities.

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

Paragraphs 50 and 51 of the consultation provide a reasonable explanation for adopting a financial materiality test *in the first instance*:

> "For the SSB to commence with a double-materiality approach would substantially increase the complexity of the task and could potentially impact or delay the adoption of the standards. Therefore, a gradualist approach is recommended. If established, the SSB would initially focus its efforts on the sustainability information most relevant to investors and other market participants. Such information would more closely connect with the current focus of the IASB.
>
> The SSB could consider how to broaden its scope as it proceeds with its work, while working with other initiatives, to provide a more comprehensive assessment of the risks and opportunities for a reporting entity. This comprehensive assessment would be particularly important if more jurisdictions embrace the double-materiality concept to minimize the risks of global and jurisdictional fragmentation of standards."

We would underline, however, that the double materiality test, and the strategic vision this brings, is an integral part of appreciating the benefit of assessing company performance by reference to the broader environment and social setting in an ever-changing world, in order to be effective in promoting transparency and investor protection.

Within Principle 3 of the UK Finance paper referenced above we observed:

> "In determining whether or not finance should be defined as 'sustainable' firms will need to be cognisant of differing forms of materiality that may apply. In the EU, for instance, materiality for non-financial information is currently based upon a dual perspective of the impact on both the firm and environment or society. While this has parallels elsewhere, it is not a universally accepted concept. The statement of intent issued by the five leading voluntary framework and standard setters in September refers to the concept of 'dynamic materiality', in which issues once considered relevant only to social value can rapidly become financially material. It observes that in this sense sustainable value creation lies at the intersection of social and corporate value."

We consider that the complexities associated with combining financial materiality with a broader materiality concept can be overcome by promoting a strong cooperation amongst the major international standard-setters and framework providers in this field.

Question 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?

As the consultation paper recognises, there are conceptual and practical challenges to achieving comprehensive external assurance. While this should be the objective, it needs to be appreciated that what might be reasonably achievable within the short term might differ significantly from what should be achievable over the medium to long term. It may therefore be that 'limited' assurance is more realistic and in keeping with what can reliably be provided. In any event, the expectation is for transparency in terms of the level of assurance provided. In this regard, the IFRS Foundation should consider the approach IASB has taken with capital, risk and segment measures, recognition and disclosures. In these areas, key elements, but not all, are addressed in IFRS Accounting Standards and consequently subject to external assurance such as IAS 1 'Presentation of Financial Statements'; IFRS 7 'Financial

Instruments: Disclosures' and IFRS 8 'Operating segments', with the focus on information relating to risk management and shared with chief decision makers within an organisation.

It will also remain critical that disclosures are made at the consolidated level. This will prevent duplicative efforts by subsidiaries and, most importantly, enable investors to take informed decisions based upon their consolidated financial exposure.

In considering this question, the SSB should also consider the relevance of its global reporting standards, and their external verification, to the investment community and supporting agencies, including ESG index rating agencies. These are of growing relevance and their influence arguably merits their processes being subject to a significantly higher level of accountability, transparency and stakeholder engagement.

Additionally, an international reporting standard on sustainability would make it easier to adopt an international assurance standard. The position of the IFRS Foundation in the international landscape may also ease the interaction with the International Audit and Assurance Standards Board (IAASB). The existence of a single reporting standard would also make it possible to bring assurance of non-financial statements closer to the level of assurance on financial statements.

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

We simply wish to reiterate our support for this initiative and to underline the extent to which we view the IFRS Foundation working with a full complement of stakeholders, building upon work to date, as representing the key to success. UK Finance and its members would be happy to support any stakeholder outreach that the IFRS Foundation may need to set up to enable the way forward.

For further information on this submission please contact Paul Chisnall, Director, Sustainability, UK Finance paul.chisnall@ukfinance.org.uk