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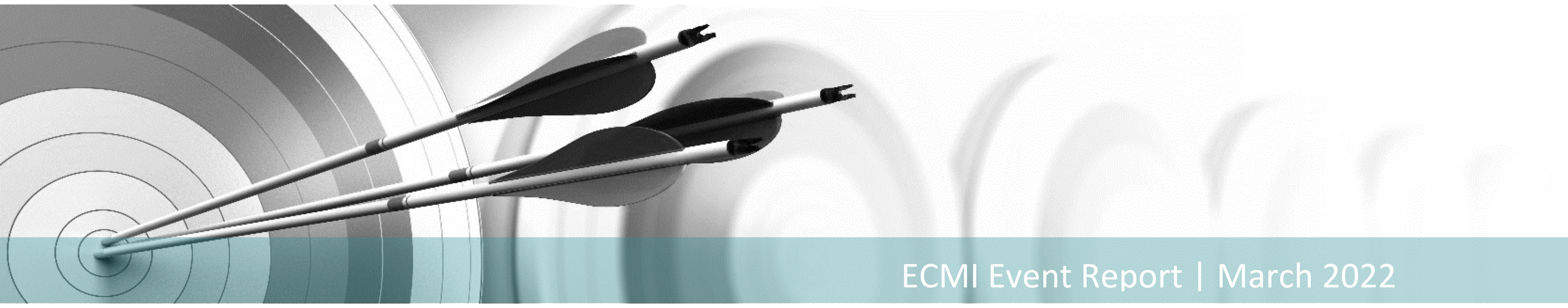

International standards for sustainability: fighting an uphill battle?

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Notwithstanding the benefits, the fragmentation and multiplicity of corporate (sustainability) reporting frameworks have also increased costs for companies, investors and regulators. On 3 November 2021, the IFRS Foundation announced the creation of the International Sustainability Standards Board (ISSB), with the first set of standards to be released during the second half of 2022. How will these new standards translate into practice? What are the key aspects to consider when devising solutions at the international level?

The demand from investors for high-quality, reliable and comparable information is increasing. Striking the balance between substance, (double) materiality and alignment is not an easy exercise. The added value for a jurisdiction such as the EU is not evident, especially considering the scope of the Corporate Sustainability Reporting Directive (CSRD), the mandate given to the European Financial Reporting Advisory Group (EFRAG), and the link with the EU taxonomy.

International standards

The development of international sustainable reporting standards has been largely driven by the demands from both retail and institutional investors. It is important to remove competition between different layers of regulations and responsible institutions and to develop a global baseline, consisting of a comprehensive set of high-quality sustainability disclosure standards. The 'alphabet soup' of disclosure practices currently in place is impairing the ability of markets to channel capital into sustainable investments, according to ISSB chair Emmanuel Faber. The rich experience with international financial reporting standards (IRFS) serves as an example in terms of the decision-making process and differences across jurisdictions. However, the urgency and scope are much more different this time around in the case of sustainability standards. From a technical standpoint, the Monitoring Board is overseeing the activities of

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the IFRS Trustees regarding the Accounting Standards (IASB) but also the Sustainability Disclosure Standards (ISSB).

As for the interaction with the other global reporting initiatives, for example the Global Reporting Initiative (GRI), cooperation is key to promoting compatibility and convergence and for building on what already exists or will be built to contribute to global progress. Full substitution is highly unlikely at this stage. At international level, there will be a focus on investors and company value while the broader stakeholder group and double materiality at EU level has been recognised as paramount. The mandatory reporting regime that will be established by the European Commission in the CSRD will act as a stepping stone for more integrated reporting.

Corporate reporting

Sustainability reporting should be aligned with corporates' policy objectives, to strengthen the enforceability of the mandatory regime with the CSRD. All large, limited liability companies with 250 or more employees are required to have a broader swath of ESG information audited under the CSRD. Qualitative and reliable data on companies is key for investors to reorient capital and select products that are sustainable but also for assessing the overall risks on corporates' financial health. Understanding the impact of sustainability risks at each step of the value chain is also key for portfolio analysis and investment.

The information needs to be standardised for reporting purposes but also to meet expectations from stakeholders, including governments. With this objective, CSRD should create a virtuous cycle in which the needs of corporates and financial institutions are met, in order to grant users a minimum level of quality assurance, whilst relying on the same methodology. Within companies, governance should be fully aware of sustainability reporting and foster it to promote accountability. The ISSB should also establish clear auditing standards.

Investors' expectations

Regulatory implementation timelines are currently not in sync and the industry is undertaking efforts to build classification systems to comply with sustainability disclosures at product and entity level. Additionally, overall ESG data divergence posing aggregation and analysis challenges is ultimately affecting investment feasibility. Standardisation is needed to eliminate the complexity of the entire process. Data and data management/storage at company level is also key. There is also the problem with the plurality of frameworks. For example, the French and German classification framework that goes beyond the SFDR's Art 6, 8 and 9 and thus have different levels of sustainability integration. The UK will have a separate taxonomy and classification system, and five categories of ESG/sustainable fund products compared to three in the EU's SFDR.

Looking ahead

At EU level, EFRAG was tasked with conducting the preparatory work and elaboration of draft standards in the context of CSRD. The European Commission has its own due process for Delegated Acts (and not non-binding Guidelines). Speed is of the essence with the implementation of the different requirements as, given the risk of green/social washing, investors might be misled if the quality of reported information is poor. It requires us to act fast, at a pace that cannot be compared to that observed for financial reporting. Regular revisions should be automatic. Although the European Commission has announced support for the ISSB, the EU has already moved ahead with its own, more ambitious climate disclosures for companies.

There is not the luxury of a decade to deal with all these technical issues that need to be addressed quickly, with many industry representatives having strong expectations from this initiative, supporting international convergence and a European alignment of standards and guidelines. For example, the IFRS standard was successful – a binding requirement for 7 000 listed companies in the EU with additional possibilities for those that are non-listed.

The myriad of EU initiatives targeting sustainability (Green Taxonomy, Social Taxonomy, CSRD, SFDR, and the revisions to MiFID 2/ IDD, UCITS/AIFMD and the Directive on Corporate Sustainability Due Diligence) will unfold over the coming years and the link with the real economy on both the supply and demand sides needs to be reinforced, with both the public and private sectors playing their role in contributing to policy objectives.

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