EFAMA

European Fund and Asset Management Association

EFAMA's COMMENTS ON IFRS CONSULTATION PAPER ON SUSTAINABILITY REPORTING

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A GLOBAL SET OF INTERNATIONALLY RECOGNISED REPORTING STANDARDS

EFAMA shares the urgent need to improve the consistency and comparability of sustainability reporting at a global level. We believe this is a crucial enabling factor to the success of the global efforts to mainstream sustainability in the financial sector. A global set of internationally recognised sustainability reporting standards would help establish an effective chain of information from corporates to the benefit of investors.

The growing demand for sustainability reporting standards has translated into a fragmented landscape of different public and private frameworks, each addressing different needs and presenting different approaches or specifications. As a result, the information provided by companies lacks comparability and usefulness for the wide variety of users they seek to satisfy. This limits the ability of investors to integrate sustainability considerations in their decisions. At the same time, compliance with the transparency rules introduced for asset managers is significantly challenged by the lack of appropriate data to meet these requirements. We support initiatives that seek to establish consistency. Most importantly, we support initiatives that build on existing, well-established standards. The consultation paper fittingly refers to the joint initiative of leading sustainability and integrated reporting organisations CDP, CDSB, GRI, IIRC and SASB (the so-called "group of 5"), as well as the work of the TCFD.

In this context, we agree that there is an urgent need to ensure consistency and there are merits with institutions with expertise on reporting standards at global level coming together to build a framework that can help meet the current challenges. We would therefore see the IFRS suggestion providing an added value as long as the criteria and conditions outlined hereafter are met.

THE REQUIREMENTS FOR SUCCESS

The consultation paper identifies the essential conditions that the framework should meet to be effective. In our feedback, we wish to build on those points and stress the following requirements:

- **To ensure legitimacy and broad support from financial market participants, the IFRS Foundation's three-tier governance structure would have to be substantially revised** to ensure it is centred around the needs of the investment community, which plays a crucial role in linking corporates with the suppliers of capital, and ensuring the latter are provided with meaningful and comparable information to support their investment decisions.

- **We wish to stress that ensuring global support from policymakers is a prerequisite, in particular for those jurisdictions that have already taken enhanced regulatory actions towards sustainability reporting and disclosure requirements.** As noted in the consultation paper, the European Union has taken a leading role in the development of sustainability reporting, including by establishing the International Platform on Sustainable Finance for international coordination. Through the development of an ambitious and comprehensive sustainable finance framework, the EU can count on unparalleled knowledge and expertise in the area of sustainability reporting.

- **We, therefore, believe that the IFRS Foundation should seek close cooperation with EU authorities**, reflecting this in regular outreach programmes and the geographical composition of the SSB, and to build a framework that is fully compatible with the work carried out by the European Commission and the EFRAG's project task force developing an EU standard.

- **The Foundation should ensure the reporting standards are fit for purpose for investment decisions**. The framework should be based on decision-useful information and ensure that data are measurable, transparent and comparable, adopting a 'climate-first' approach to build on more robust metrics and methodologies for environmental reporting, but gradually broadening the scope of information to other environmental and social factors. The priority should be reaching a common definition of the underlying environmental metrics.

- **Globally consistent reporting standards should be based on existing frameworks that are extensively used and have a proven track record for investee companies and investors**. It is critical to start from well-established reporting standards that have proven their effectiveness to support investment decisions, such as the *group of 5* and the TCFD.

GOVERNANCE

For the Foundation to become a standard-setter for a globally consistent sustainability reporting framework, it is important to fill the gaps in its governance structure. Such a structure should **ensure a balanced representation of the investment community and its expertise to appropriately reflect the materiality and relevance of information reported, and to achieve global recognition across sectors**. Currently, we find that the inadequate representation of investors within the IFRS Foundation is a key obstacle to the Foundation's role in setting sustainability reporting standards.

Investment managers are one of the primary users of the information reported by companies, as well as the primary preparers of the disclosures presented to end-investors. Investors' representation across the Foundation's structure is a pre-condition to achieving further consistency and global comparability in sustainability reporting and the SSB's work would greatly benefit from their input and expertise. This should be carefully reflected in the allocation of seats within the SSB.

RELATIONSHIPS WITH STAKEHOLDERS

The Foundation can leverage its network and established relationships to develop reporting solutions more quickly and effectively. At the same time, **the Foundation should further strengthen its collaboration with public authorities, improve the representation of the investment community, and build on the work carried out by other global standard setters such as the *Group of 5* and the TCFD.** We also note that an endorsement mechanism should be established for an effective transposition and recognition of global standards in EU rules, as in the case of the IFRS Accounting Standards.

EXISTING INITIATIVES IN SUSTAINABILITY REPORTING

We consider that any set of sustainability standards should be elaborated building on existing ones. The most important criteria for the success of a future global sustainability reporting standard is its capacity to be applied effectively and at a reasonable cost by preparers, and to be useful for investors and other interested stakeholders.

In addition to the current standard setters, we would encourage the IFRS Foundation to establish a strong working relationship with the EU, in light of the current preparatory work initiated by EFRAG to develop an EU non-financial reporting standard consistent with the EU legislation and regulatory requirements. This will facilitate compliance with the legislation, support companies' transition efforts, and enable financial market participants in performing their role.

This also implies that, should the IFRS Foundation move towards becoming the global standard setter also in the field of nonfinancial reporting directed at capital markets, we would envisage strong working arrangements between EFRAG and the SSB. This would ensure that companies and financial institutions with international presence do not have to report under two sets of standards and avoid that EU companies reporting under the EU standard would be required to switch from one to another in a short period, requiring double investments and adjustments of processes and IT systems.

Furthermore, we believe the IFRS Foundation should understand the diversity in terms of intended users and the approach taken in the existing different international frameworks before building upon them. Where some standards are essentially reporting frameworks, other initiatives focus more on impact and transition considerations than on reporting. In this respect a “building block approach” may be relevant, identifying areas where the initiatives would have similar coverage and user group to that expected by the IFRS Foundation and, on the other, hand initiatives going beyond this approach.

“Climate-first” approach

To develop a framework that builds on broadly accepted standards, we would support the ‘climate-first’ approach outlined in the consultation paper. **Metrics and methodologies for environmental reporting are more mature than other sustainability factors. Given the urgency of responding to the need for an international standard, and the considerable differences in how social and governance matters are defined and treated across jurisdictions, a ‘climate-first’ approach would also remove the complexity of defining globally accepted standards.** In relation to the climate-related aspects of sustainability reporting, we also believe the Foundation’s work should draw from the extensive expertise developed by the *Group of 5* and the TCFD.

At the same time, we note the increasing awareness and consideration that investors give to broader sustainability factors. We would encourage an international standards-setter to **provide a global platform for the exchange and development of reporting practices** on social and governance matters, as well as on less mature environmental reporting practices, i.e. on biodiversity. Recent developments made clear that the standardisation process takes several years to produce results. Gradually broadening the remits to include the interrelationship between environmental, social and governance factors would therefore ensure the standard remains relevant as investors’ expectations and the availability of information evolve.

Environmental factors

We believe that the SSB should start with a focused definition of climate-related risks, and later consider broader environmental (i.e. water and biodiversity issues) and social factors material to investors and lenders. Alongside the consideration of broader environmental factors, we also note that these risks will differ across industries and regions and change over time. Therefore, a static definition of climate-related risks would be impracticable and ineffective.

We also believe that the SSB should first focus on reaching a common definition of the underlying environmental metrics. The TCFD provides us with the right framework for climate-related risks but does not define the underlying metrics. We encourage international collaboration, through IFRS as well as the International Platform on Sustainable Finance (IPSF), to reach a common understanding of key environmental metrics and the underlying methods for calculating them. While mandatory reporting varies from jurisdiction to jurisdiction, most large companies voluntarily disclose environmental and social indicators performance, but the information provided varies significantly from company to company as well as the methodology used to calculate performance. For some metrics, we also find that information is often incomplete, for example on carbon emissions. Reaching a common understanding of environmental metrics, and some social ones (e.g. pay ratio or gender pay gap) can help investors more than mandatory reporting when the methodologies used diverge.

Approach to Materiality

A full-fledged double-materiality approach may further increase the complexity of the SSB's task and could potentially impact or delay the adoption of the standards. **An effective standard should start from a definition of materiality primarily focused on all decision-useful information on how the performance and risk profile of the investment might be affected by ESG factors.** Moving forward, however, we expect users to demand information on the impact of investment decisions on environment and society. To remain relevant, and cater to the needs of all sustainability-minded investors, it is important the SSB starts giving due consideration to broadening the approach to materiality indicated in paragraph 50 of the consultation paper. **The work that is already being carried out in the EU should set solid foundations to the process of integrating double materiality in a global standard.**

At least in its first iteration, a global framework can be developed following a gradual process and be based on principles aligned with the progress on sustainability reporting made across different jurisdictions. In its approach to materiality, **the SSB should seek to simplify reporting for all companies, including smaller ones, while providing investors with meaningful information to account for all relevant and material sustainability-related factors.**

External Assurance

As global reporting practices mature, and quantitative information start replacing qualitative ones, sustainability information should gradually become auditable and subject to third-party assurance. Verification is a useful tool to ensure the reliability of disclosures and methodologies. For asset managers, assurance helps providing end-investors with accurate information and to be able to consider sustainability risks in the investment process with the same reliability as the information found in financial statements.

At the same time, we believe that a strict requirement for this information to be subject to external assurance may be premature, and the added costs might discourage the standard's adoption. Therefore, in the initial stage of the project, we recommend to focus on defining reliable and consistent metrics, and to develop standards that allow users to verify material information and key environmental and social metrics for which a calculation method has been established.

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About EFAMA

EFAMA, the voice of the European investment management industry, represents 28 Member Associations, 60 Corporate Members and 24 Associate Members. At end Q3 2020, total net assets of European investment funds reached EUR 17.6 trillion. These assets were managed by more than 34,200 UCITS (Undertakings for Collective Investments in Transferable Securities) and almost 29,400 AIFs (Alternative Investment Funds). At the end of Q2 2020, assets managed by European asset managers as investment funds and discretionary mandates amounted to an estimated EUR 24.9 trillion.

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