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IOSCO Issues Final Report on Sustainability-related Issuer Disclosures

This client alert, part of a series focused on ESG disclosure and regulatory developments, should be read together with our ESG Lexicon, available here, which provides definitions of some of the key terms used in ESG reports, disclosures and regulations.

Efforts to create an international sustainability standards board have grown since the International Financial Reporting Standards (IFRS) Foundation published in September 2020 a consultation paper to assess the demand for global sustainability standards (available here). In February 2021, the International Organization of Securities Commissions (IOSCO) announced in a press release (available here) that it supports the IFRS Foundation's efforts to establish the ISSB, and plans to work with IFRS Foundation towards this end.

On June 28, 2021, the Board of IOSCO published a report (the "Report"), available here and developed by its Sustainable Finance Taskforce (STF), that sets out a vision for a global baseline for investor- and enterprise value-focused sustainability standards for issuers. The Report, which is responsive to one of the three mandates of the STF, namely to identify decision-useful categories of issuer disclosures for the benefit of investors and the wider market, sets out the STF expectations for an International Sustainability Standards Board (ISSB). As envisioned by the IFRS Foundation, an ISSB would sit alongside the International Accounting Standards Board, building on and integrating the content and recommendations of existing frameworks, principles and guidance, including the TCFD recommendations, and incorporating a "building blocks" approach that would enable certain jurisdictions to set reporting requirements beyond the ISSB's baseline.

Background

The Report notes that while climate change is a key driver of investor demand for more consistent, comparable and reliable sustainability disclosures, the current disclosure landscape is characterized by a multiplicity of diverse sustainability frameworks and standards, lack of common definitions of sustainable activities and greenwashing and other challenges to investor protection. The STF found, through its engagement with asset managers, that asset managers view sustainability-related disclosures as incomplete and inconsistent across companies. The voluntary nature of reporting, together with the number and variety of sustainability-related disclosure frameworks, potentially leads to selective reporting against different standards and frameworks. In the absence of a common international standard, asset managers see value in investee companies' reporting systematically against established frameworks and standards and value investor-oriented, industry-specific information in respect of all three 'ESG' categories. The STF also found that asset managers value a mix of narrative information and quantitative metrics, and wish to see linkage between a company's sustainability risks and opportunities and its business, strategy and financial performance.

The STF identified further areas for improvement and focus in disclosures. For example, issuers generally provide sustainability-related disclosures that aim to meet multiple stakeholder needs (e.g., shareholders, government, suppliers, employees and customers) on core sustainability themes. In addition, while issuers do provide a mix of qualitative and quantitative information, quantitative information is limited and not consistent. Moreover, there is inconsistency in the location (e.g., annual reports, standalone reports, corporate websites, etc.) and timing of disclosure, as well as in the application of audit and assurance processes.

The STF concludes that asset managers' priorities for improvement in sustainability-related disclosures include the creation and adoption of a mandatory common international standard for sustainability-related financial reporting and better integration of sustainability reporting with financial reporting. The STF found that asset managers generally support more stringent sustainability reporting requirements for issuers. Some asset managers also call for enhanced digitization and storage of sustainability information, such as a structured electronic tagging system to support machine readability and a (global) central repository. Most asset managers favor the use of the TCFD recommendations for climate-related disclosures, and for sustainability topics beyond climate, many asset managers encourage the use of SASB and in some cases also GRI.

Priorities

Based on the foregoing, the STF outlines the following priorities:

- Encourage progress towards globally consistent application of a common set of international standards for sustainability-related disclosure across jurisdictions, covering the breadth of sustainability topics and leveraging existing principles, frameworks and guidance.

- Promote greater emphasis on industry-specific, quantitative metrics in companies' sustainability-related disclosures and standardization of narrative information.

- Drive international consistency of sustainability-related disclosures with a focus on enterprise value creation, while also supporting mechanisms to coordinate investors' information needs on wider sustainability impacts. This involves promoting closer integration of these two aspects with reporting under current accounting standards frameworks and facilitating independent assurance of disclosures.

Action Items

IOSCO welcomes the work of the IFRS Foundation in establishing an ISSB, and considers a strong governance foundation to be critical to achieving this goal. The ISSB could bridge the divide between financial and sustainability reporting and help meet investor demand for more coherence and internal consistency between sustainability-related financial disclosures and financial reporting. The Report notes that, as a membership organization of the world's securities regulators, IOSCO is in a unique position to underpin market acceptance of independently-determined standards by endorsing the IFRS Foundation's system architecture for sustainability standard setting and encouraging members and relevant authorities to consider these standards when setting national or regional sustainability-related disclosure requirements.

In developing the ISSB, the IFRS Foundation Trustees have confirmed an initial focus on climate, while also working towards meeting the information needs of investors on other ESG matters in the future. They expect to build on existing frameworks, by further developing a Prototype for climate-related financial disclosures (the "Prototype")[1] with a view to delivering this to the ISSB as a running start for its standards development work.

IOSCO envisages that the ISSB's future standards, sitting alongside financial reporting standards and with a focus on enterprise value creation, would form the first block of a "building blocks" approach, providing the global baseline. This would be complemented by other 'blocks' (applicable standards), which may be jurisdiction-specific and may focus on wider sustainability impacts or other disclosures that extend beyond the ISSB's enterprise value creation orientation, but could be based on consistent and comparable metrics and methodologies.

Future Reporting Standards

The STF notes that the six ESG groups that formed an alliance to create the Prototype (TCFD, SASB, GRI, CDP, IIRC and CDSB) have different target outcomes, objectives and audiences and, therefore, it is not surprising that there are calls for more consistent standards. IOSCO encourages the IFRS Foundation to conduct a more detailed assessment to determine the extent and manner of adaptation of the Prototype to meet investor needs on sustainability reporting. In particular, the STF notes that sustainability reporting should be integrated with financial reporting standards in such a way to ensure that sustainability issues impacting companies' financial position and performance are adequately assessed and disclosed, and that financial statements also reflect these issues.

The Report concludes that a new regime must reflect investor demands for completeness, consistency and comparability of sustainability-related information that provides investors with the necessary information to accurately assess the impact of sustainability issues on companies' ability to create and preserve enterprise value. At the same time, internationally comparable disclosures should facilitate efficient pricing of sustainability risks and opportunities across issuers and markets to better inform capital allocation decisions.

As for scope and materiality, disclosure topics should include: physical and transition risks arising from climate change, wider environmental and social issues where identified via multi-stakeholder, intergovernmental, science/evidence-based approaches, and governance matters, such as inclusion of sustainability topics in terms of reference for board committees and the full board, as well as management responsibilities and processes. Requirements should also address industry-specific guidance, including materiality mapping, activity metrics and scenario analysis parameters, and provide for materiality assessments, reflecting company size, business model and geographical factors.

Narrative disclosures and quantitative metrics should provide guidance for:

- standardized/consistent and detailed management discussion and analysis across specified content elements;
- granular, science-based metrics and methodologies;
- gap analysis against objective science-based criteria;
- granular, structured historical, current and forecast data; and
- disclosure of short, medium and long-term targets with timelines, scenario analysis and underlying assumptions.

The Report also suggests that there should be linkage between sustainability issues and business strategy/financial implications and highlights necessary guidance and framework features towards this end, such as a framework that can be integrated with financial reporting standards and facilitate independent audit and assurance.

Looking Ahead

Momentum in favor of an ISSB has been gaining internationally. The G7 Finance Ministers and Central Bank Governors announced in early June 2021 (see here) that they welcome the IFRS Foundation's work to "develop this baseline standard under robust governance and public oversight, built from the TCFD framework and the work of sustainability standard-setters, involving them and a wider range of stakeholders closely to foster global best practice and accelerate convergence." Days later, the IFRS Foundation announced the establishment of an advisory group, chaired by Former European Central Bank President Jean-Claude Trichet, to provide strategic advice and counsel to IFRS Foundation Trustees on the formation of the ISSB.

Among U.S. regulators, responses to the ISSB have been mixed. In March 2021, the SEC's then-Acting Director of the Division of Corporation Finance John Coates stated in public remarks that "ESG problems are global problems that need global solutions for our global markets," and noted that "in this regard, the work of the IFRS Foundation to establish [an ISSB] appears promising."[2]

In April, U.S. Treasury Secretary Janet Yellen expressed support for the IFRS Foundation's efforts to establish an ISSB. This is particularly significant since President Biden's recent Executive Order on Climate-Related Financial Risks calls for the Secretary of the Treasury to work with the Financial Stability Oversight Council (which includes the SEC) to review climate-related disclosures,[3] which could potentially impact the course of the SEC's current review of climate-related disclosures and related guidance.[4] That said, SEC Commissioner Hester Peirce issued a public statement earlier this month (available here) opposing the IFRS Foundation's efforts to create an ISSB.

Investors should follow these developments closely as we approach the November 2021 COP26 U.N. climate change conference, when the ISSB is due to be unveiled, and anticipate further U.S. and international regulation on ESG disclosures. It is worth noting that days after the publication of the Report, IOSCO published a consultation report (available here) that requests feedback on five recommendations that securities regulators and/or policymakers should consider in order to improve sustainability-related practices. This will continue to be a dynamic space in the next few years, and it is possible that we will see a greater shift from voluntary disclosures to regulated and/or mandatory disclosures.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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1 The Prototype for climate-related financial disclosures was published in December 2020 (available here) by TCFD, CDP, CDSB, GRI, IIRC and SASB. The Prototype builds from the form and structure of the TCFD's recommendations and applies a mix of narrative and quantitative disclosures (these include backward-looking, contemporaneous and forward-looking metrics and targets – including cross-industry and industry-specific metrics).

2 For more on these remarks, see our related client alert, SEC's Coates Calls for "Adaptive and Innovative" Policy on ESG Disclosure.

3 For more on President Biden's executive order on climate-related financial risk, see our client alert, President Biden Calls on Federal Government to Mitigate Climate-Related Financial Risk.

4 For more on the SEC's recent review of ESG disclosures, see our recent client alert, SEC Poised to Consider ESG Disclosures.