IFRS Consultation on Sustainability Reporting

IA Response

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £8.5 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 40% of this is for overseas customers. The UK asset management industry is the largest in Europe and the second largest globally.

Executive summary

The IA and its members believe there is a clear and urgent need for internationally agreed sustainability reporting standards. We therefore welcome this opportunity to provide our feedback on the IFRS Foundation’s proposals and extend our support for the creation of Sustainability Standards Board to develop global sustainability standards, subject to certain conditions.

Our members invest on behalf of millions of savers in the UK and around the world, seeking investments that deliver long-term value. Long-term value assessments are not limited to share price performance or dividend yields. Investors increasingly take a more holistic approach. This means ensuring that companies are well governed and addressing material risks to their long-term value. This involves addressing a wide range of material sustainability issues including environmental, social and governance (ESG) issues which present risks and opportunities to the long-term value of the company. This is to the benefit of the end savers, who are seeking long term returns from their investments.

Meaningful and comparable sustainability reporting allows investors to factor these material issues into their investment process, contributing to more efficient asset valuations and targeted engagements. Investors are currently not receiving the clear and consistent disclosures from companies they require to fulfil this role.

Investment managers’ ability to direct where capital is allocated and monitor its use will thus be a crucial part of building a more sustainable global economy. Public interest in sustainability and responsible investment is as high as it has ever been. Investment managers’ responsibilities as stewards of capital have never been more obvious – or in demand. The clients of IA members are increasingly considering sustainability and ESG issues as part of their investment objectives, with record investment of £7.1bn into responsible investment funds during the first three quarters of 2020, 275% more than in the previous year[1] .

However, at present, the number of sustainability reporting frameworks available is daunting: companies are unsure which framework to use making it challenging for investors to factor comparable reporting and metrics into their investment process.

Accordingly, the IA agrees with the UK's Asset Management Taskforce's[2] Stewardship Working Group call to "support ongoing efforts to harmonise corporate reporting standards for sustainability". It is only through a more harmonised approach to sustainability reporting, that is global in coverage, that sustainability risks and opportunities will be appropriately factored into the investment process. This will accelerate efforts to build more sustainable companies and economies.

The IA appreciates the wealth of knowledge and expertise the IFRS Foundation would bring to harmonising these standards within a publicly accountable governance structure that could gain the support of a wider range of stakeholders. We are therefore pleased to provide our support for the IFRS Foundation's proposals, subject to:

- The SSB not unduly delaying the adoption of global sustainability reporting standards.
- The SSB building on existing sustainability reporting frameworks with investor support, such as SASB and TCFD, rather than creating additional complexity through a completely new set of standards.
- The SSB's standards meeting investor needs as the primary users of corporate reporting. This should include a clear definition of materiality in line with the definition in IAS 1 and assurable information that is decision-useful for investors and other market participants.
- The SSB receiving the respect of investors and capital markets internationally.

1. Is there a need for a global set of internationally recognised sustainability reporting standards?

Yes. The IA is supportive of efforts to create internationally recognised sustainability reporting standards that meet the needs of investors, other stakeholders, and the planet.

IA members invest on behalf of millions of savers in the UK and around the world, seeking to deliver long term returns on behalf of their clients. Achieving this is the result of informed capital allocation and engaged stewardship practices that ensure companies are responding to the relevant issues and appropriately managing their risks and maximising opportunities.

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[1] Investment Association Monthly Market Research; November 2020: https://www.theia.org/media/press-releases/recordps71bn-flows-responsible-investment-funds-2020-so-far

[2] The UK Asset Management Taskforce Stewardship Working Group brought together the UK government, senior representatives from the investment management industry, regulators and other key stakeholders to consider how to improve the UK asset management industry. The IA provided the secretariat for their most recent report on stewardship: Investing with Purpose; placing stewardship at the heart of sustainable growth.

Accurate sustainability reporting from companies allow investment managers to accurately assess the long-term value potential of companies and the material risks to the company, meet client demand, and contribute to a more sustainable future.

Public interest in sustainability and responsible investment continues to grow. Our clients, whether individual retail savers or institutional asset owners such as pension funds, insurers, charities, and governments, are increasingly considering sustainability as part of their investment objectives. As such, the investment management industry's responsibilities as stewards of capital – including the need to fully integrate societal and environmental impacts into their investment decision-making process – has never been more crucial.

Investment managers are reliant on the information companies report. Quality sustainability reporting can contribute to accurate asset valuations, allowing investment managers to fully integrate the risks posed by climate change and other sustainability concerns into their investment process. Quality reporting creates clear signals as to where investors can provide the necessary support or challenge to companies to transition to more sustainable business models. This should lead to better long term value creation by the company as well as wider benefits for the economy, society, and the environment.

The IA has therefore been supportive of efforts to improve sustainability reporting. Several initiatives have already begun to meet investor needs. Notably, the recommendations provided by the Taskforce for Climate-related Financial Disclosures and the standards produced by the Sustainability Accounting Standards Board already have significant traction with investors, companies, and regulators. TCFD-aligned disclosures look set to become the norm from the UK (which set out a roadmap for mandatory TCFD-aligned disclosures by 2025 across the UK economy) to New Zealand (which committed to mandatory TCFD-aligned disclosures by 2023).

The UK's Asset Management Taskforce Stewardship Working Group, which the IA provided the secretariat for and which brought together the UK Government, senior representatives from the investment management industry, regulators, and other key stakeholders, recently published its recommendations for placing stewardship at the heart of sustainable growth. These called for regulators and investors to "support ongoing international efforts to enhance and harmonise corporate reporting standards for sustainability"[3].

IA members believe that the frameworks provided by SASB and the TCFD are already responding to the need for quality sustainability reporting standards. However, SASB and TCFD are not an exhaustive list of standards. There remain a great number of initiatives looking to fill the demand. This leads to a disparate picture, with too many differing standards for companies to choose from and consider - with no single standard to report against, are not yet providing meaningful, consistent, and comparable sustainability disclosures. No single standard also means that sustainability reporting is rarely assured– raising the question as to how robust the information investors do receive is. Mandatory TCFD-aligned disclosures are a step in the right direction. A more comprehensive set of standards would be a turning point.

While SASB and TCFD are meeting the needs of investors, we are aware that some stakeholders do not believe that these comprehensively meet the needs of public interest –

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[3] Asset Management Taskforce – Investing with Purpose; Placing stewardship at the heart of sustainable growth 2020

considering the positive and negative adverse impacts of companies on society and the environment. An independent body receiving feedback from a wider range of stakeholders, including investment managers, to produce a single set of global standards would therefore be welcomed.

a) **If yes, should the IFRS Foundation play a role in setting these standards and expand its standard-setting activities into this area?**

The IA supports, in principle, the IFRS Foundation's proposals. There are, however, several concerns that we believe the IFRS Foundation should address in developing this work, we discuss these through the response.

The IA recognises that the IFRS Foundation would bring several essential qualities to this role. The IFRS is already a respected authority in accounting standard setting, with a track-record of creating quality standards. Its publicly accountable governance structure will allow for a rigorous and transparent process. Its history of creating auditable standards will be key; sustainability standards that can ultimately be subject to audit will be crucial if investors are to be able to trust the information received and use it effectively.

We also expect the IFRS Foundation to leverage synergies between the IASB's financial reporting standards and the SSB's sustainability standards. As the line between what was once considered 'financial' and 'non-financial' continues to blur, this will be a welcome benefit. The sustainability reporting standards should be created with a view to greater interplay between these disclosures.

In creating the SSB, we believe the IFRS Foundation will have to address the following issues:

- The speed at which developments are evolving in the reporting space – The IFRS Foundation will have to work at pace to develop their standards to ensure that their efforts are not superseded by other initiatives in the interim.
- Complexity risks – In an already crowded-field, an additional reporting standard runs the risk of adding an additional layer of complexity and confusion. The IFRS Foundation should therefore seek to consolidate and build on existing frameworks (SASB and TCFD in particular) to minimise the disparity between what already works and what the SSB creates.
- Stakeholder Support – The IFRS Foundation will need to be confident that the SSB's standards will be received as definitive and global rather than another option. This will require support from all stakeholders globally, in particular global investors and companies in a wide range of countries, particularly the largest capital markets. Only with this support can the standards achieve their global ambition.

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.

As noted in our response to Question 1, the IFRS Foundation is well placed to further consistency and global comparability in sustainability reporting. This is in large part due to its experience in bringing forward new standards, as demonstrated by the accounting standards brought forward by the IASB. It is therefore logical to pursue a similar approach to sustainability reporting.

The IA stresses the need for urgency in this matter. It is imperative that the IFRS set out clear timelines for the delivery of the new standards that is met with approval by the identified key stakeholders, including the investment management industry which will be the primary user of the subsequent disclosures.

In determining the composition of the SSB, we would encourage the IFRS to work closely with existing standard setters to ensure an accelerated transfer of knowledge and expertise and to further reflect the need to build on existing frameworks. The SSB should also ensure that the investor perspective, as the primary users of the information disclosed by the proposed standards, are well represented across the governance structure.

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)?

As noted in the rest of our response, the IFRS is in principle well placed to further global sustainability reporting standards. We would echo each of the requirements for success listed in paragraph 31, with a particular emphasis on ‘A’ and ‘B’:

a) *achieving a sufficient level of global support from public authorities, global regulators and market stakeholders, including investors and preparers, in key markets* – The SSB will only be a success if it can secure and retain global support. Initial signs, including the backing of the UK Treasury, regulators and SASB, to name a few, are promising. However, support from other Governments, regional jurisdictions, including the largest financial markets globally, and other actors, including the IOSCO Sustainable Finance Taskforce will be crucial.

The IFRS should find the right balance between canvassing support and delivering robust and high-quality standards in a timely manner. To achieve this, the IFRS should quickly establish key stakeholders and prioritise their support. Delivering quality standards that become the norm for companies and meet the material needs of the primary users of corporate reporting – investors – will facilitate wider support over time.

b) *working with regional initiatives to achieve global consistency and reduce complexity in sustainability reporting* – A risk of these proposals is that they introduce another player into the already crowded field of sustainability reporting. The IFRS’s involvement would be detrimental if it were to add complexity to sustainability reporting. This can be avoided by aiming to consolidate and build upon the existing standards and frameworks, rather than seeking to create an entirely new set of standards. The SSB will need to work closely with existing global organisations working in the sustainability reporting field and in particular TCFD and SASB – see our response to question 5 for further details.

In addition to the requirements for success listed in paragraph 31, the IA advocates two further requirements for success:

- Timeliness
- Auditable Standards

Timeliness should be a primary requirement for success. It is crucial that the focus is on bringing high-quality standards in a sufficiently timely manner. Simply put, the SSB will not be a success if the standards it produces are years in the making.

The standards developed by the SSB will ultimately need to be suitable for audit and assurance. The importance of sustainability factors to the long-term value of companies means that they require similarly robust assurance processes as the financial information required by IASB. Please see our response to Q10 for further details.

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?

The IA and its members are keen for the development of a single global set of reporting standards that can be adopted by companies and investors around the world. It will be important that the IFRS Foundation use its existing relationships to ensure that this happens.

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

How the SSB builds on the work of existing initiatives in sustainability reporting will be key to its success. The IA does not think that the IFRS developing standards from scratch would be an effective means of achieving global sustainability standards. Instead, in line with the recommendations of the UK's Asset Management Taskforce Stewardship Working Group, the aim should be to "enhance and harmonise" existing frameworks.

We strongly encourage the SSB to focus on creating a coherent and unified set of standards that draw heavily on the work of SASB and the TCFD. This is for two reasons:

1. Existing support - Existing initiatives have already received investor support and are increasingly being used to inform investment decisions. Likewise, existing initiatives already have support from governments and regulators, as noted below.
2. Urgency – The current dangers of climate change, and the increased risks if action is taken immediately, are a reminder of the need for sustainability reporting standards at the earliest opportunity. Given the support for existing initiatives, the development of entirely new principles would not reflect the urgency of the situation.

TCFD and SASB already have a significant amount of traction with global investors and regulators – in addition to the IA's support, the SEC's Asset Manager Advisory Council (SECAMAC) and the Investment Company Institute (ICI) have both signalled their support for SASB, and TCFD is widely adopted and supported by investors. The UK's Joint-Government-

Regulator TCFD Taskforce recently announced[4] its roadmap to mandatory TCFD-aligned disclosures across the financial sector and companies by 2025.

Investors have welcomed the materiality and governance emphasis of these standards, as well as their industry-specific focus. They are already the basis for developing ESG integration into the investment and capital allocation process. Both standards are embedded in principles of materiality and strong governance. This emphasis ensures a dynamic rather than static consideration of sustainability factors, enabling focused engagement on how companies are transitioning their business model to a more sustainable footing.

Sector specific considerations are also crucial. SASB's 77 sector-specific standards help investors compare the long-term value of companies within sectors on a consistent basis. Likewise, the TCFD recommendations include helpful sector-specific guidance. Sustainability issues differ by sector, and even where there are similar sustainability concerns these can manifest differently in different sectors. It is vital that any sustainability standards adequately reflect the unique materiality concerns of different sectors if they are to provide an accurate picture. If the SSB's standards are not sector-specific, investors will go elsewhere to receive this information – re-creating the disparate environment the SSB is seeking to overcome. We strongly encourage the SSB to retain this approach, by building on SASB and TCFD.

Finally, as explored in our response to question 7, the adoption and enhancement of existing standards would allow the SSB to broaden its remit without significantly delaying delivery of new standards. This would avoid the arbitrary distinction of concentrating only on "climate-related" standards first. SASB, for instance, already provides standards across a range of sustainability concerns. This would enable the SSB to produce standards that meet the needs of companies, investors, and their clients, as well as other stakeholders, across the full range of sustainability concerns.

6. How could the IFRS Foundation best build upon and work with existing jurisdictional initiatives to find a global solution for consistent sustainability reporting?

Efforts to tackle climate change and other sustainability concerns must be global. Companies seek capital from around the world and investors will often operate across multiple jurisdictions. New sustainability standards will need to receive the support of jurisdictions around the world.

In the UK, the support for TCFD from regulators, including the FRC and FCA, in addition to support from HM's Treasury, speak to the importance of building on existing frameworks. There is already a solid base of support, which will shortly be followed by regulatory alignment. Naturally, building off these frameworks would immediately align the SSB's standards with the approach favoured by the UK Government and regulators.

The EU has adopted a double materiality lens for its sustainability reporting standards. The SSB will have to consider how its standards interact with the EU's Renewed Sustainable Finance Strategy and Non-Financial Reporting Directive. This should not affect the SSB's standards: as explored more fully in our response to question 9, a double materiality lens does not make sense for the SSB's stated aims and we would encourage the SSB to focus on

[4] UK joint regulator and government TCFD Taskforce: Interim Report and Roadmap - GOV.UK (www.gov.uk)

investors as the primary users and financial materiality. The SSB will need to be cognisant of how companies could build a double materiality overlay into their disclosures in addition to the SSB's standards to meet the needs of regulators in the EU and other jurisdictions. It would be helpful for the SSB to work with the EU, and the European Financial Reporting Advisory Group, as they develop their thinking in this area.

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

No. The IA would encourage the SSB to be given a broader remit than "climate-related financial disclosures", a remit that better captures the range of sustainability concerns.

The reasons for proposing a narrow focus are obvious. The IA has noted in its recent position paper that climate change is one of the single biggest systemic risks facing society and the planet today. The need for urgency is clear. However, we would note that companies around the world are already starting to make significant progress on climate disclosures with the introduction of TCFD requirements by several jurisdictions. We also note the significant progress already made by the five major standards setters - CDP, CDSB, GRI, IIRC and SASB on developing a climate prototype disclosure[5].

The demand from IA member clients for sustainable and responsible investment goes beyond climate-related concerns to include the full range of ESG issues. Companies should be considering the full range of sustainability concerns that are material to long-term value, and investors should be able to integrate these into the investment process.

SASB's standards cover 'five dimensions of sustainability': environmental, social capital, human capital, business model and innovation, and leadership and governance. SASB's example proves that financial materiality can be applied across these five dimensions. The SSB should not limit its global standard to climate-change but should instead work to build on the five dimensions of sustainability already identified by SASB.

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

As in our response to Question 7, the SSB should have a definition that considers the financial materiality of broader sustainability, including environmental factors.

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

The IA agrees that the SSB should "focus its efforts on the sustainability information most relevant to investors and other market participants" as the primary users of the information in the initial stage.

We broadly agree with the IFRS' definition of materiality: "information is material if omitting, misstating, or obscuring it could reasonably be expected to influence decisions that primary

[5] Reporting-on-enterprise-value_climate-prototype_Dec20.pdf (netdna-ssl.com)

users of general-purpose financial statements make on the basis of those financial statements". This approach is strengthened by its simplicity and its focus on supporting the decisions of investors and other market participants – who, as the consultation notes, are the prime audience of financial reporting.

We would note that the concept of materiality is becoming increasingly blurred, especially as you consider it over the long-term investment time horizons – it clear that companies' activities have an impact on society, the environment, and the economy; that these in turn impact on the financial performance of a company; and that the society, environment and economy in which companies operate also present risks and opportunities to their long-term value.

To reflect this double materiality lens, it is appropriate for individual jurisdictions to expect minimum disclosures on the positive and negative impacts that companies have on society, the environment, and the economy to meet public transparency objectives. This information empowers a wide range of stakeholders to hold companies to account, including end investors who wish to make informed choices about their investments. Notably, global investors operating in EU markets need companies to make these wider range of disclosures to meet new disclosure requirements (Taxonomy Regulation and the Sustainable Finance Disclosure Regulation (SFDR)).

While this could be considered an important second phase of the IFRS' work, in the first instance, the IFRS should focus on developing robust global standards from a financial materiality lens. The IFRS already has experience creating standards that rely on financial materiality. It is this experience with the IASB that provides the foundation for the proposals. We would encourage the SSB to develop standards that play to the IFRS' strengths and create synergies between the disclosure of financial and non-financial information.

Our opposition to double materiality at this stage is two-fold and relates to the primary issues identified in our response to question one:

- Time
- Global support.

Time - As the consultation notes, "a double-materiality approach would substantially increase the complexity of the task and could potentially impact or delay the adoption of the standards". Initial efforts to create a global sustainability reporting standard should prioritise a timely delivery, for reasons re-iterated across our response.

Once the initial standards have been developed, the SSB will have the time and scope to consider how a double materiality lens can be applied.

Global Support – Critical to the success of the standards will be their adoption across the globe, including in key capital markets. There are concerns that if the SSB were to adopt a double materiality lens, there is a risk that some key capital markets, which favour financial materiality, would not support the standards. This would jeopardise the 'global' nature of the standards and would discourage even those companies and investors in other jurisdictions from adoption.

On the other hand, as noted in our response to question 6, the EU favours a double materiality lens. We do not believe this would stop companies and investors in this market from adopting the SSB's single materiality standards. Rather, we would expect SSB's standards to be adopted and then augmented by additional provisions to fit the regional requirements. In time, it may be that the SSB assists in providing additional guidance for the standards across different jurisdictions that then include double materiality.

However, the SSB's initial focus should be on the creation of a single standard that supports the financial decision-making of companies and investors. It is through this approach that real change will be affected.

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?

The SSB's goal should be to create standards that are designed to be assurable and will ultimately allow for the audit of sustainability information. Assurance is a cost that is ultimately borne by the end beneficiaries of the investment process. It is important therefore to ensure that assurance adds rather than detracts from value across the investment chain. Consistency of reporting in line with a global standard is an essential first step - IA members do not believe that the standards should be subject to mandatory audit at this stage. Nonetheless, in the long run, assurance should be the end target.

Investors rely on the quality and robustness of the information provided by companies when making investment decisions -it is essential that investors have confidence in the quality and accuracy of sustainability disclosures. Assurance goes some way to providing this confidence. In the IA's response to the FCA's consultation on climate-related disclosures, we noted that the promotion of common frameworks for reporting, like TCFD, sets the foundation for which non-financial information can be assured.

In the UK, auditors are already required to assess whether there is any inconsistency between the narrative disclosures provided by the company and the company's accounts. However, at present, the audit of non-financial information is limited.

While the direction of travel is promising – the Brydon Review of audit in the UK called for an expanded audit scope which included APMs and KPIs – the need for a consistently applied reporting standard, which auditors can audit against, is clear. It is therefore imperative that the SSB consider whether the information required by their standards is auditable. As noted in our response to Q3, this should form one of the requirements for success. As the comparability and consistency of reporting increases, we would expect greater levels of assurance. It is this greater level of assurance that the SSB should work towards.

11. Stakeholders are welcome to raise any other comment or relevant matters for our consideration?

No further comments.