IFRS Foundation consultation on sustainability reporting: FCA response

We welcome the consultation paper published by the Trustees of the International Financial Reporting Standards (IFRS) Foundation, exploring the potential role the IFRS Foundation could play in sustainability reporting.

We particularly welcome the Trustees considering the option of establishing a new Sustainability Standards Board (SSB). We recently signed a joint statement with the UK Government and the other UK financial regulators voicing support for the direction of travel proposed in the consultation paper.

A timely initiative

This recognises the urgency of the climate challenge and the increasing focus on the role of business in society. Governments, regulators and society around the world all demand decisive action from financial markets.

These combined pressures have not receded as a result of the coronavirus (Covid-19) crisis. If anything, they have increased. Internationally, policymakers are determined not to lose momentum on the sustainability agenda, and many are targeting a green recovery from the pandemic. In the case of climate change, although the UN Climate Summit (COP 26) has been deferred, it has set an ambitious private finance agenda to maximise its impact when it does take place in 2021.

Promoting good disclosures

As the climate crisis and the global pandemic have revealed, sustainability-related financial impacts can crystallise rapidly. That's why one of the key components of our sustainable finance strategy at the FCA has been to promote good disclosures right along the investment chain: from companies; to market participants; to end-investors.

The Trustees' proposals can help meet the needs of capital markets and advance securities regulators' objectives in this area. In a globally connected financial market, a common international standard would improve the completeness, consistency and comparability of corporate information on sustainability, and the future assurance of this information.

Capital markets rely on good disclosures to inform asset pricing, risk management and capital allocation. There are also important flow-on benefits to the design, delivery and disclosure of sustainable products. This includes clearer terms in product disclosures and performance reporting, which benefit consumers and can encourage competition in consumers' interest.

Consistency with our approach

We believe the Trustees' proposals are consistent with the FCA's strategic objective to make markets function well. They are also consistent with our sustainable finance policy priorities. Disclosure and transparency have been at the centre of much of our work, both domestically and internationally.

For example, we recently consulted on a new Listing Rule to encourage our most prominent listed companies to make better disclosures about how climate change affects their businesses, referencing the internationally-accepted recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD). Our consultation closed in October 2020.

We are aiming to finalise our policy position by the end of 2020. We intend to introduce this rule for reporting periods beginning on or after 1 January 2021. We see this as a first important step in implementing the TCFD's recommendations in our rules. The steps we are taking are part of a wider coordinated strategy with the UK Government and other UK regulators, as set out in a Roadmap towards mandatory climate-related disclosures.

We are also examining how more detailed sustainability reporting standards can complement the principles-based approach in the TCFD's recommendations. As part of this, we are co-chairing a workstream at the International Organisation of Securities Commissions (IOSCO). This group is examining options to address the challenges – for both users and preparers – arising from multiple and diverse frameworks and standards for sustainability reporting.

Why we are supporting the IFRS Foundation's proposals

We strongly support moves towards a common international standard for sustainability reporting that builds from the TCFD's recommendations and other existing frameworks and standards. And we think that the IFRS Foundation is a natural candidate to take on a standard-setting role here.

The Foundation already has widespread international market acceptance in financial reporting, supported by the integrity, independence, transparency and public accountability of its governance arrangements. Furthermore, we see considerable benefit in integrating standard-setting for financial and non-financial reporting under a common architecture.

Along with IOSCO colleagues, we have been engaging actively with both the IFRS Foundation's proposals and other promising industry initiatives in this area. These initiatives include the harmonisation work of an alliance of the leading sustainability standard-setting organisations (CDP, Climate Disclosure Standards Board (CDSB), Global Reporting Initiative (GRI), International Integrated Reporting Council (IIRC), and Sustainability Accounting Standards Board (SASB)), facilitated by Deloitte, the Impact Management Project and the World Economic Forum.

To date, these initiatives have been progressing in parallel. Both through IOSCO, and individually as FCA, we stand ready to help to bring these initiatives together and drive them forward in a way that will best meet the needs of capital markets, and serve the public interest.

We elaborate on some of these observations in our responses to each of the questions in the consultation paper. We have set them out in the Annex.

Annex. Responses to the IFRS Foundation's consultation questions

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 this area?

(b) If not, what approach should be adopted?

Yes. We see a strong need for a global set of internationally recognised sustainability reporting standards and consider that the IFRS Foundation should expand its standard-setting activities into this area.

Companies began producing Sustainability and Corporate and Social Responsibility (CSR) reports several decades ago. The practice has become more widespread internationally since the 1990s, with further advances in recent years.

However, sustainability reporting tends to remain a siloed activity within companies. Recent studies have observed that sustainability disclosures remain incomplete and inconsistent across companies, and do not yet provide markets with the information they need to make informed decisions. See, for example: Network for Greening the Financial System (NGFS) report on bridging data gaps; a recent report by the US Government Accountability Office; and a report released for consultation by the World Economic Forum's International Business Council, and subsequent white paper.

In relation to climate change, the recommendations of the TCFD, published in 2017, have raised the profile of climate-related corporate reporting. Almost 1,500 organisations have publicly endorsed the recommendations, and the TCFD's most recent status report reveals continued progress globally in disclosing in line with the recommendations. However, the TCFD concludes that much more needs to be done.

Furthermore, given the principles-based nature of the TCFD's recommendations, consistency in reporting will not necessarily be achieved. Ultimately, it is likely that the TCFD's recommendations will need to be complemented with more detailed reporting standards that promote greater consistency and comparability and support comprehensive assurance.

Investors are increasingly calling for this. Environmental, social and governance (ESG) considerations are becoming more fully integrated into mainstream investment activity, and consumer demand for sustainability-oriented investments continues to grow. Investors have therefore become more vocal in encouraging companies to enhance their reporting on sustainability matters, and to align their disclosures with existing voluntary standards.

Some leading investors and investor groups, including the Investment Association in the UK, have publicly encouraged investee companies to disclose in line with the TCFD's recommendations and the standards promulgated by the Sustainability Accounting Standards Board (SASB). Similarly, in a position paper, Norges Bank Investment Management suggests that boards use SASB's industry-specific metrics for financially material risks and opportunities, and base broader disclosures on the GRI Standards.

We think that a global set of internationally recognised sustainability reporting standards – beginning with climate – that build from the TCFD's recommendations will provide helpful additional granularity and specificity, thereby promoting consistency and comparability.

We see a strong case to afford sustainability reporting the same level of rigour and governance that is observed today in financial reporting. Robust standards that are applied in a way that is consistent with those used for financial reporting would also support assurance, giving the market comfort regarding the quality and reliability of non-financial information.

We think that the IFRS Foundation is a natural candidate to take on a standard-setting role here, subject to meeting the criteria in the 'key requirements for success' set out in paragraph 31 of the consultation paper (see Question 3). The IFRS Foundation already has widespread international market acceptance and its governance arrangements are designed to serve both capital markets and the public interest (see Question 2).

Question 2. Is the development of a sustainability standard board to operate under the governance structure of the IFRS Foundation an appropriate approach to achieving further consistency and global comparability in sustainability reporting?

Yes. To uphold the integrity of capital markets, the system for corporate reporting must be transparent, independent and serve the public interest. As noted in IOSCO's report on the role of securities regulators in sustainable finance, the widespread adoption of IFRS standards reflects certain key attributes, including: public accountability and independence; rigorous, transparent and participatory due process; a clear mission statement and defined target audience; assurance standards; a robust process for the evolution of standards.

The IFRS Foundation's three-tier governance structure is designed to deliver on these attributes. We therefore welcome the Trustees' proposal in paragraph 29 of the consultation paper to insert the SSB within this structure, alongside the IASB. This would give an international standard for sustainability reporting the best chance of achieving market acceptance. The market would otherwise need to establish, or create in another body, a structure similar to that already in place for the IASB. Establishing an SSB under the existing architecture is therefore an efficient, and potentially quick, way to achieving the credibility that the standard-setting body will need.

We agree that the existing governance structure should be able to continue to operate effectively without material adaptation. It is acknowledged, however, that it may be necessary to bring additional skills and competencies into the existing structure. Funding and resourcing will therefore be critical issues to resolve (see Question 3).

We note the reference in the consultation paper to the need for a balance of professional experience and interests in the Trustee group. For instance, the IFRS Foundation may need to appoint additional Trustees with specific expertise in sustainability reporting. There may also be a strong case for some common board membership with the IASB in order to assess the interlinkages between financial and non-financial reporting.

We also see considerable benefit in bringing standard-setting for non-financial reporting together with financial reporting under the same architecture. As contemplated in a recent Accountancy Europe publication, we support establishing a formal conceptual framework for connected reporting to promote a comprehensive approach. For instance, the 'Accounting for Climate Change' initiative has observed that the sustainability information in companies' annual financial reports is often not internally consistent with the financial statements in those reports.

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)?

The list of 'requirements for success' set out in paragraph 31 of the consultation paper is critical. These are rightly presented as prerequisites for the proposed model. Before securities regulators are prepared to endorse this standard-setting architecture, they will need to be confident that sustainability standard setting can be introduced safely, without compromising the IFRS Foundation's existing mission or disrupting the effectiveness of the current model for financial reporting standards.

Since the IFRS Foundation does not currently have experience in sustainability reporting, bringing in the appropriate expertise will be essential. Resourcing and funding will therefore be particularly important in order to maintain the quality of standard setting in existing financial reporting, ensuring that this work is not adversely impacted by expanding the remit. To meet this need, the IFRS Foundation may be able to leverage the expertise and resources of the existing voluntary sustainability standard-setting organisations.

Ultimately, we hope that regulators and markets internationally will value the prospect of sustainability standards produced under a framework that has the integrity, independence, transparency and public accountability of the IASB. Bringing standard-setting for sustainability under the established structure may help accelerate agreement among markets and regulators on an acceptable resourcing and funding model for the SSB.

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?

Yes. With more than 140 jurisdictions having adopted IFRS standards for financial reporting, the IFRS Foundation already has extensive global reach. We expect that the IFRS Foundation can leverage this reach – with both regulators and users – to build buy-in for the SSB and encourage adoption of the new sustainability reporting standards once they are available.

We also encourage the IFRS Foundation to use this consultation to engage with those jurisdictions that have not already adopted its financial reporting standards, emphasising the benefits of a comprehensive corporate reporting system.

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

We welcome the Trustees' recognition of the importance of engaging with other existing initiatives in sustainability reporting, including TCFD and the alliance of leading standard-setters (p10). The paper also acknowledges official sector initiatives such as those of IOSCO and the Network for Greening the Financial System (NGFS) (p5).

We agree with the message in the recent exchange of open letters between the alliance of standard-setting organisations and Erik Thedéen, chair of IOSCO's Sustainable Finance Taskforce, that it is important to bring these initiatives together. We see the initiatives of the IFRS Foundation, TCFD and the alliance of standard-setters as highly complementary.

We also agree with the view in Erik Thedéen's letter, that in combination these initiatives can deliver the 'content' that capital markets demand, within a governance structure that is transparent, independent and serves the public interest.

Along with IOSCO, the FCA is committed to playing its part in joining the dots between these initiatives, while also standing "ready to be involved in the design of the governance aspects of the comprehensive global reporting system if the IFRS Foundation decides to move ahead following feedback to its consultation paper".

Further to the Statement of Intent published in September, we understand that the alliance of standard-setters is working on a follow-up paper. We expect this paper to demonstrate, by way of a worked example (or 'prototype'), how the TCFD's recommendations, and the principles, frameworks and standards developed by the organisations in the alliance could be brought together to form the basis for common international standards under the IFRS Foundation's system architecture, beginning with climate.

We strongly encourage the Trustees to continue to engage with IOSCO and the ongoing work of the alliance. In particular, we encourage the Trustees to explore how the SSB could leverage the alliance's follow-up work to accelerate progress towards climate standards that build on the already widely accepted foundations of the TCFD's recommendations and existing frameworks and standards.

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?

We encourage the Trustees to engage with the 'building blocks' approach that has been proposed by the alliance of standard-setters in the Statement of Intent.

We recognise that different stakeholder groups have different interests, and that priorities differ across jurisdictions. A modular building blocks approach would accommodate jurisdictions' adopting sustainability reporting at different speeds, while maintaining a common core of internationally compatible standards.

For example, some jurisdictions may wish to adopt standards for reporting on matters material to sustainable development (double materiality), just as the EU has done in adopting its wider materiality concept in its non-binding guidelines for reporting climate information. Some may also wish to add bespoke, jurisdiction-specific requirements, perhaps reflecting interactions with other regulations or legislation.

Question 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?

Yes. Given the urgency of the climate challenge, we support the IFRS Foundation's focusing initially on climate change, before broadening the scope of sustainability reporting. Given the breadth of sustainability factors, it could take some time to develop standards encompassing the full range of sustainability factors.

Beginning with a more limited scope, the Foundation should be able to progress more quickly, especially if the SSB were able to leverage the work that the standard-setters are currently doing to build the foundation for a climate standard (see Question 5). In this way, the IFRS

Foundation should be able to keep pace with the ambition of the private finance agenda ahead of COP 26.

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

Yes. For the reasons set out in Question 7, we support a narrow focus on climate-related financial disclosures initially, before broadening out to wider sustainability factors, including other environmental factors.

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

Yes. We agree that the IFRS Foundation should retain an investor/market focus and financial materiality lens, at least initially.

As noted in paragraph 50 of the consultation paper, this would be more closely aligned with the current focus of the IASB. We expect, therefore, that this approach will help to build buy-in and allow the IFRS Foundation to integrate the SSB with minimal disruption. Again, we expect that this will help to promote consistency between the sustainability information in companies' annual financial reports, and the financial statements in those reports (see Question 2).

Similar to the rationale for limiting the focus to climate initially, adopting a financial materiality lens at the outset should help to accelerate progress (Question 7). Those jurisdictions that are ready to adopt a double materiality focus could then apply the modular approach referenced in Question 6, layering this onto the common standards developed by the SSB.

Importantly, if the building blocks approach is to deliver the comprehensive corporate reporting system that the alliance of standard setters envisage, and gain regulatory and market acceptance, the separate blocks, and the bridge between them, would need to operate in accordance with the governance attributes discussed under Question 2.

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?

The target should be for users to be able to place equivalent reliance on financial and sustainability reporting. This means that we should aim for equivalent governance standards, not only in standard setting, but also in the preparation of reports. Ultimately, external assurance is likely to have an important role to play in upholding the quality of reporting, providing comfort to users that the standards have been met. This can be expected to become ever more important as the market develops its approach to integrated reporting.

In consulting on our proposed new Listing Rule for TCFD-aligned disclosures, we noted (p28): "We see an important role for assurance of these disclosures in time. However, our current view is that introducing mandatory requirements around verification or assurance would be premature, especially noting ongoing reviews of audit and acknowledging the still largely evolving reporting practices among issuers. It would also add to cost." Respondents generally agreed with this view.

We expect that issuers and their service providers may similarly not be ready for third-party assurance of disclosures against a new climate (or broader) sustainability reporting standard. However, achieving a level of assurance, comparable with that in financial reporting, should be the ultimate target. In the long run, we see this as promoting a common approach to materiality and measurement principles, again improving the coherence between the sustainability information in financial reports and the financial statements.

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

N/A