DIVERGENCE OF ESG APPROACHES AT THE GLOBAL LEVEL

JOHN BERRIGAN

Director General,
DG for Financial Stability, Financial Services and Capital Markets Union, European Commission

Toward a comprehensive and coherent EU sustainability reporting framework

Sustainability or Environmental, Social and Governance (ESG) reporting from investors and companies is a key driver of a more sustainable financial system. It allows investors to better manage risks and generate sustainable, long-term returns for investors and for society, by exerting a positive influence on the behaviour of companies.

Transparency about the sustainability performance of companies also allows companies to signal their transition efforts to investors and stakeholders.

For this reason, the EU has put in place a comprehensive disclosure regime throughout the financial value chain. This disclosure regime aims to increase transparency about impacts, risks and opportunities, as well as strengthen market discipline, discourage green-washing and foster innovation in the design of financial products.

Basic information must be provided by non-financial institutions engaged in economic activities that have an impact on sustainability and are exposed to sustainability factors. Therefore, companies will be required to report improved sustainability information under the proposal for a Corporate Sustainability Reporting Directive (CSRD), proposed by the Commission in April 2021 (and revising the Non-Financial Reporting Directive). If adopted, the proposal would ensure that all large companies and all listed companies, including listed SMEs (except listed micro enterprises), disclose relevant, reliable and comparable sustainability information.

> The comprehensiveness and consistency of the EU sustainable finance reporting framework.

Mandatory EU sustainability reporting standards are the centerpiece of the proposal. Commissioner McGuiness recently invited the European Financial Reporting Advisory Group (EFRAG) to begin the technical development of standards in parallel to the negotiation of the CSRD proposal by the European Parliament and EU Member States. The objective is to adopt the first standards by October 2022.

Large non-financial and financial companies must also meet additional disclosure requirements under the Taxonomy Regulation. A delegated act on Article 8 of the Taxonomy Regulation, adopted on 6 July, provides the content, methodology and presentation of the disclosures that large European companies (including financial institutions) will need to make against the EU Taxonomy.

Financial market participants are also required to disclose to their end investors the sustainability impact of their investment products, activities and processes. This obligation is enshrined in the Sustainable Finance Disclosure Regulation (SFDR), which applies from 10 March 2021. The SFDR establishes common rules for institutional investors inform their clients about potential sustainability risks that could affect the value of their investments and how those risks are being managed, the potential adverse impact of investments on the environment or broader society and how sustainable products deliver their green or sustainable objectives. In addition, the SFDR requires products with certain sustainability-related ambition to disclose their degree of Taxonomy-alignment.

As a complement to the sustainability disclosure regime, sustainability preferences are to be included in investment and insurance advice. To this end, the Commission adopted several delegated acts on 21 April 2021 aimed at giving retail investors more information and empowering them to formulate sustainability preferences, if they wish to do so.

The EU sustainable reporting framework provides a comprehensive and consistent set of requirements across the value chain. The Commission is committed to ensure a high level of coherence between the different requirements. Companies' future sustainability reporting standards under the proposed CSRD should be consistent with Europe existing legal framework, in particular the SFDR and the Taxonomy Regulation. The development of EU standards will both build on and contribute to global standardization initiatives. In this respect, future draft EU standards intend to take into account international standard setting initiatives, including the proposed International Sustainability Standards Board (ISSB), or the Global Reporting Initiative. EFRAG is currently in contact with a number of global standard-setting initiatives, including the IFRS Foundation, to discuss the modalities of cooperation and a "co-construction" approach.

BERNARD MENSAH
President of International, Bank of America

The importance of a common data approach in non-financial reporting

The EU continues to act at speed to tackle the shared challenge of climate change, with the European Commission proposing a number of important initiatives in recent months. At Bank of America we also remain strongly committed to taking action to address climate change, and a particular area of focus has been to support the development of consistent metrics in order to measure the impacts of different economic activities.

We supported the work of the WEF's International Business Council, chaired by our CEO Brian Moynihan, to develop a common framework, the Stakeholder Capitalism Metrics. These draw from a range of existing standards and represent a common, core set of metrics and recommended disclosures to align sustainability reporting, reduce fragmentation, encourage the convergence of existing standards toward a single, global common standard, as well as encourage faster progress towards solutions to environmental and social challenges. So far around 80 global companies from every region and across a diverse range of industries have indicated their commitment to reporting under the Metrics.

Harmonisation of reporting and disclosure standards will help ensure that the financial effects of climate change can be more broadly considered by the financial markets and stakeholders can evaluate the progress being made with consistent, transparent, and assurable data.

In July, G20 Finance Ministers and Central Bank Governors highlighted the increasing risks posed to financial stability from climate change, and noted that "quality data and comparable frameworks of disclosure are crucial for addressing climate-related financial risks and mobilising sustainable finance".

We welcome the creation by the International Financial Reporting Standards (IFRS) Foundation of the International Sustainability Standards Board (ISSB) and support the IFRS "climate first" approach to non-financial reporting. This will help create a global harmonised approach to disclosures; standardised disclosures will, in turn lead to improved asset pricing as markets absorb the information based on those standards. The SEC is also working towards consistent standards for ESG disclosure, focusing first on climate change and human capital.

Climate change is a global challenge and one that will require international approaches...

Bank of America is pleased to be a founder member of the Glasgow Financial Alliance for Net Zero (GFANZ) and the Net Zero Banking Alliance (NZBA). GFANZ, chaired by Mark Carney, UN Special Envoy on Climate Action and Finance, brings together over 160 firms responsible for assets in excess of $70 trillion in aggregate to accelerate the transition of the global economy to net zero emissions by 2050 at the latest. Likewise, NZBA members are committed to aligning operational and attributable emissions from their portfolios with pathways to net-zero by 2050 or sooner. Brian Moynihan also co-chairs HRH The Prince of Wales' Sustainable Markets Initiative, which has catalysed cross-industry work in this area.

At Bank of America, we have also formed the EMEA ESG Strategic Council, which I chair and which is led by two of our most senior bankers in the region. This recognises the leading role Europe is playing in addressing the challenges of climate change and bringing green finance into the mainstream. The new Council will help us to assess and manage our climate-related risks as well as support our clients in their low-carbon transition, while providing an important forum for co-ordination of our activities internally.

For financial services firms, gathering and analysing data and understanding and reporting comprehensively on climate risks are a key part of our sector's response to climate change. In all the initiatives described here, we can see the benefits of international co-operation. We would therefore urge policymakers and regulators around the world to maintain a collaborative approach in order to avoid multiple different standards developing – an outcome which risks being costly, time-consuming and resource-intensive for businesses while not helping to deliver the solutions required.

Ultimately, climate change is a global challenge and one that will require international approaches if it is to be successfully addressed.

SIMON HARRIS
Managing Director, Global Financial Institutions, Moody's Investors Service

Consistent, transparent ESG disclosures assist in assessing related credit risk

An assessment of credit implications stemming from ESG risks, or of credit risks more broadly, can be better informed by data. In many areas of analysis quantitative data is plentiful, and in others less so. But in each case Moody's approach to assessing credit risk remains one that relies on analytic judgement, supported by data. Consistent, standardised data assists in comparing credit risk across financial institutions, and development of more uniform ESG disclosures will be valuable in informing our ESG Issuer Profile and Credit Impact Scores.

In establishing ESG Issuer Profile and Credit Impact Scores, Moody's makes a qualitative assessment of the rated entity's ESG profile and the impact of that profile on its credit rating. Our focus is on credit-relevant ESG considerations. In making assessments for individual entities, we have drawn on a number of quantitative inputs to help inform our analysis – as we do for other aspects of assessing credit risk – including selected World Bank and United Nations data for sovereigns. We expect to follow a similar path as we introduce these scores for financial institutions.

The ESG data we are most focussed on are those most relevant to assessing the credit implications of ESG. We look at an issuer's sustainability initiatives through that lens – assessing, for example, if such initiatives support or damage customer, counterparty or regulatory perceptions of an issuer.

Financial institutions face a number of competing, non-converging standards with respect to ESG disclosures, whether for accounting, regulatory or other non-financial purposes. As financial institutions analysts, we regularly deal with such inconsistencies when assessing financial and other risks. A prime example is disparities between accounting systems and reporting and regulatory requirements globally. Nevertheless, this lack of consistency creates complexity and cost as well as opacity around the materiality of ESG issues.

Development of more uniform ESG disclosures will be valuable for financial institutions analysis.

Moody's supports the Task Force on Climate-Related Financial Disclosures (TCFD) principles of transparency with respect to climate-related financial disclosures. The TCFD '4 pillars' approach covering Metrics and Targets, Risk Management, Strategy and Governance particularly aligns with our forward-looking, holistic approach to credit risk assessment. And the insight we gain from interactions with issuers is especially valuable in understanding the likely credit impact of their ESG strategies.

We expect that the TCFD framework will help gradually form consensus on the most informative metrics. In the meantime, we encourage issuers to adopt similar disclosures, where possible, which will improve comparability, reduce transaction costs and start a path toward standardised data metrics. It will also provide a better framework for issuers to explain, and investors to assess, firms' progress on climate-related initiatives such as the route to a 'net-zero' greenhouse gas global economy.

Climate-related risks – such as a bank's loan exposure to carbon emitters or an insurer's exposure to rising sea levels – are an increasingly important focus of Moody's credit analysis. Social and governance risks are also significant considerations – for example in our private-sector rating actions in 2020, 71% mentioned social risk factors, 53% governance issues and 13% environmental issues. And in an analysis made in early 2019, we found that governance issues led to 'corporate behaviour' adjustments for 8% of the banks we rate globally. These findings underscore the importance of a consistent, standardised approach to disclosing and discussing such risks. As a result, Moody's sees considerable upside from the IFRS Foundation proposal to develop a Sustainability Standards Board, with the goal of achieving further consistency and global comparability in sustainability reporting.

DANIEL HANNA
Global Head,
Sustainable Finance,
Standard Chartered Bank

Time is running out: urgent action is needed to scale climate finance

"Code red for humanity". The Intergovernmental Panel on Climate Change's report on climate science, published in early August and around 90 days ahead of COP26, made for sobering reading.

It is encouraging then that the G7 Leaders' Summit and G20 Finance and Environment Ministers' meetings, which took place earlier in the summer, saw greater ambition from the world's largest countries in tackling climate change.

We urgently need to turn this level of ambition into reality.

To stay on track with critical targets outlined in the Paris Agreement, net carbon emissions must fall 45% by 2030 (from 2010 levels). Missing those targets would put the world on course for the worst consequences of climate change.

The private sector is moving. Over 3000 business have now signed the 'Race to Zero'. At Standard Chartered, we have committed to reaching net zero in our operations (Scope 1 and 2) by 2030 and across our financed emissions (Scope 3) by 2050. We will publish a consultation later this year so our stakeholders can input to our roadmap.

To support private action, we need to ensure a standardised policy framework to catalyse climate finance.

Material progress has been made on reporting, with G20 countries (among others) supporting the Taskforce on Climate-related Financial Disclosures (TCFD) framework – something that has been underway for some years within financial services. This is critical. Our Zeronomics report (https://www.sc.com/en/insights/zeronomics/) found that 81% of senior managers believe standardised, globally consistent measurement and reporting standards would help accelerate their net zero journey.

More is needed. Double materiality should be agreed as the foundation of reporting approaches. We not only need to understand the risk that climate poses to us and our clients, but we urgently need to understand, measure and reduce our impact on the world – and this extends beyond climate change to issues such as biodiversity degradation.

We encourage more interoperability. Full harmonisation will take years; years we don't have.

We also need policymakers to implement and extend TCFD reporting across their economies. Smaller companies should face proportionate regimes and transition should not be stifled by burdensome regulation. However, more effort is required to increase, improve and harmonise data and disclosures from all sectors of the economy, in particular from emerging markets which are the most at risk from climate change but also represent the biggest investment opportunities.

Disclosure is a critical tool in unlocking investment in the fight against climate change and the delivery of sustainable development globally. To complement this, we need standardised taxonomies covering both green (Paris-aligned) and transition activity. As these develop across the world, we encourage more interoperability. Full harmonisation will take years; years we don't have. Taxonomies need to be designed with a focus of channelling capital to where it is needed most.

Most of the world's population lives in emerging markets, and if economies with vast populations like India and China do not transition to net zero, efforts in the developed world will have a limited impact. However, 80% of companies and 79% of investors say there is a significant gap between net zero transition investment directed at developed and emerging markets.

Finally, policymakers need to consider and implement regulatory incentives towards sustainable finance. While estimates vary, it is uncontroversial to say that the scale of climate finance required – and sustainable finance more broadly – is staggering. Better data, reporting and risk management, underpinned by common definitions, will create change. While policies put these in place, measures can be introduced to remove distortive pricing effects and create better pricing incentives for climate- or sustainable-aligned finance.

Encouraging progress is underway at the global level and across economies. In turning ambition into reality, we don't have years to create the perfect regulatory framework. We are currently on track for 1% emissions fall by 2030, a long way short of the 45% needed. The time for urgent and pragmatic action is now.

KATSUNORI YOKOMAKU

Deputy Regional Executive for EMEA , MUFG Bank, Ltd.

The path to a net zero banking industry

We are living in extraordinary times; containing a pandemic in the short term while facing a climate crisis in the long-term. It is still too early to assess the real impact of COVID-19 on the economy, however now is a good time to reflect on the way the financial system, in particular, has been an essential support in the current pandemic. Although the nature of the global threats facing us today are different, there may be resemblance in the strength of the financial system to form part of the solution.

The banking reforms following the GFC kept our banks financially robust and resilient during the pandemic. This was an essential component of the economy's ability to transition to the 'new normal' without imposing risks to the financial system. Additionally, the response of public authorities would not have been as efficient without close national and international coordination at all levels. It is now clearer than ever that a global crisis needs a global response.

When it comes to climate change, society's attitude is shifting fast and so are the ESG strategies of private institutions. This is a positive development; the world must move fast if it is to tackle climate change. Since the Paris agreement only five years ago, society has raised its expectations even further. 126 governments, including Japan, have set 2050 targets and are shaping their plans about how the transition to net zero will be achieved. Setting end targets is necessary to understand where we want to be, but it will become increasingly important to set out the detailed plans of how to get there. Decarbonisation pathways of specific industry sectors across the key regions are key in determining whether we are on track.

Over 1500 private institutions committed to TCFD have been making tremendous progress to enhance their disclosure capacities to mitigate the risks associated with climate change. This has provided valuable insights into banks' exposure to carbon intensive sectors. In Japan, the TCFD consortium was established in 2019 and today, it has 428 members. We are pleased to see that the global five standard setters[1] are using TCFD as the basis for a global ESG reporting standard. We need to aim for a single ESG reporting standard for everyone.

Let us not lose sight of what we have already achieved and enable the global financial system to be part of the solution.

More recently, a significant number of large financial institutions, MUFG included, have signed up to institution specific net zero commitments. For banks, this means net zero by 2050, but also 2030 emissions reduction targets with respect to their lending, investment and advisory activities and services. Individual institutions' ambitions will help speed up the transition, but there are many pieces (based on industry specific methodologies for measuring emissions) that need to be considered. And let us remember that bank targets will not only depend on the ability of clients' to transition, but also the decarbonisation pathways of the economies in which they operate.

Mandatory ESG disclosure standards at regional level can cause divergence, making it more difficult to remain aligned with evolving global standards, designed by the IFRS based on TCFD. Therefore, it remains important that third country banks can rely on global voluntary standards for their EU-based entities while we are building a single global standard.

The financial sector is making an unprecedented shift to support the transition to a low carbon economy. We will have to accept a certain extent of geographical fragmentation in the speed of the individual economies to transition. However, what we should not accept is imposing regional divergence and fragmentation that poses burden on exactly those institutions that will be instrumental in helping the world to transition. Let us not lose sight of what we have already achieved and enable the global financial system to be part of the solution.

Let us build climate-risk resilient global financial institutions, strive for strong global supervisory and regulatory coordination and provide the necessary time for the private sector to thrive in the transition.

[1] CDP, the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), and the Sustainability Accounting Standards Board (SASB) and the International integrated Reporting Council (IIRC)

HESTER M. PEIRCE

Commissioner,
U.S. Securities and Exchange Commission (SEC)

ESG for Thee, but not for me

As a Commissioner of the United States Securities and Exchange Commission («SEC»), I am charged with regulating, among other entities, investment advisers. Responding to and fueling investor interest in sustainable investing, many investment advisers are offering ESG products and services. ESG offerings, however, require advisers to collect sustainability information about the issuers in whose securities they invest. Collecting such information is difficult because there are many different, sometimes inconsistent, sources for such information. Advisers are, therefore, among the strongest proponents of enhanced ESG disclosure mandates for issuers. Although they have not yet coalesced around any particular set of data points or any one reporting framework, they hope that a regulatory mandate will force uniformity.

As the SEC contemplates whether and how to respond to the advisers' call for issuer ESG disclosure, several points warrant consideration.

Regulators should beware of double materiality ... it cannot translate into a workable regime.

First, lack of uniformity is normal around issues of ambiguous significance to financial value. Advisers' diverse approaches to ESG are helpful in identifying material disclosure items for particular geographical or industrial sectors. The current inconsistency speaks to the fact that investors (as opposed to certain non-investor stakeholders) do not yet know what they want, assuming that they want anything at all, regarding ESG reporting.

Second, consistency is not a good in itself, and imposition of a standard that has not arisen organically would benefit only the companies hired to assist with implementing the standard and companies that have successfully lobbied to receive a "green" ranking in the standard. As Ralph Waldo Emerson said more than a century ago, "A foolish consistency is the hobgoblin of little minds, adored by little statesmen and philosophers and divines." Substitute growing numbers of regulators for statesmen.

Third, over the opposition of many investment advisers, a standardized framework for issuers will likely feed into a standardized framework for asset managers. Here too consistency might not serve investors well as it will limit the types of approaches to sustainable investing from which investors can choose.

Fourth, regulators should beware of double materiality, which threatens to be so vast and shapeless that it cannot translate into a workable disclosure regime.

Finally, as tempting as it is to use the asset managers and other financial firms we regulate to push sustainability throughout the economy, well-intentioned regulatory constraints can impede the ability of the financial services industry to support society's goals for economic, social, and environmental prosperity.

The views I represent are my own views and not necessarily those of the Securities and Exchange Commission or my fellow Commissioners.