

# ESG global reporting standards: addressing consistency and greenwashing issues

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## 1. Requirements for reducing existing green confusion and costs, and fostering sustainable investment

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### 1.1 More interoperable non-financial reporting standards globally are necessary

An industry representative remarked that having sustainability reporting plays a central role in the transition. For financial institutions to fulfil their commitments and regulatory requirements, they need relevant, consistent and reliable sustainability reporting. Currently, there are multiple reporting frameworks unlike with financial information. Sustainability reporting also needs to be of equal quality to the financial information.

The current reporting requirements have to reflect both local public policy and regulations, which creates an extra-territorial dependency. For global reporting there should be interoperability between the different standards.

An industry representative stated that standardisation forms a real challenge. Everybody wants robust and reliable standards, but there is a whole host of standards which measure slightly different things.

Proper governance and a proper reporting framework are needed, which means an internal control process. Everything already available in financial information is needed for these new environmental, social and governance (ESG) reporting standards.

However another industry representative suggested that convergence should not follow the route the EU has taken in financial reporting. Indeed while there is US generally accepted accounting principles (GAAP) decided by the US democratic process, there is no EU GAAP. Conversely a European firm follows accounting rules that are not decided in Europe. Although there will be a great deal of discussion, the US will ultimately decide on their standards of conduct for US firms and that will be it. Consequently there is an issue of democratic deficit in Europe.

### 1.2 Data availability and quality is a precondition to scale sustainability commitments and meet investment requirements

Data availability and quality are very important. Data related to small and medium-sized enterprises (SME) are outside the scope of the reporting.

An industry representative noted the need for reliable and comparable data to make informed investment decisions. There is an estimated \$4 trillion per year needed in investment in innovation, clean energy and infrastructure, which is three times more than the current amount. That requires confidence in the data available. Companies and banks need reliable data to scale sustainability commitments and move sectors through the transition.

### 1.3 The data challenge must be addressed at the global level

An industry representative noted that most reporting obligations arise in developed markets while most of the business is done in emerging markets. SMEs and larger organisations in those markets do not have available data, so there is a real data gap.

There are also consistency, reliability, and repeatability concerns in terms of the quality of the data. Some of that is because the methodologies for considering and measuring carbon emissions are still evolving. That is before even getting into areas where only the surface has been scratched, like biodiversity.

### 1.4 Opportunity and impact are specifics of non-financial reporting

This matter should be considered not only from a risk perspective but also from an opportunity and impact perspective. Given where the transition financing needs are, the impact on ultimate carbon reduction from funding a solar or wind project in India is much greater than funding for the same in France, because the energy mix is different.

## 2. Defining interoperable non-financial reporting requires difficult political agreements at the global level

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An industry representative suggested there may be a false symmetry between financial reporting and sustainability reporting. It is going to be much harder to agree on what is and is not fine in the way corporations should behave. Within Europe there is not agreement about which of coal and nuclear energy is green. When moving to shale gas or fracking, Europe will disagree with the US. The Japanese will have much to say about nuclear energy. There will be political differences in determining which sources of energy are green.

### 3. The EU and the International Financial Reporting Standards Foundation (IFRS) Foundation are both addressing the urgent need for non-financial reporting standards

#### 3.1 Corporate Sustainability Reporting Directive (CSRD) and the taxonomy, which go beyond climate-related issues

A policy-maker suggested that the EU is the frontrunner in sustainable finance, and it cannot stop and wait for the rest. It has started to build up a sustainable reporting framework with the CSRD. The taxonomy is also an important element in this. There are equal criteria, and they are all linked together. It is important to have clarity on the standardisation and ESG. It is also very important to adhere to the principle of double materiality. Proportionality is also an issue.

#### 3.2 Striving for convergence and global cooperation

A policy-maker agreed that alignment should be striven for as much as possible, but the political agendas have to be considered. Cooperation at the global level is key. The CSRD incorporates the key elements of the Taskforce on climate-related financial disclosures (TCFD) recommendations developed by the Financial Stability Board.

#### 3.3 A dedicated governing body within the European Financial Reporting Advisory Group (EFRAG) will prepare sustainability reporting standards within the EU

An official explained that EFRAG is tasked with the elaboration of sustainability standards for submission to the European Commission, which will adopt them as delegated acts and create a playing field for every business in scope.

EFRAG is currently finalising its new governance with a new pillar dedicated to sustainability reporting standard setting. This will be in place in March. The work has been at the request of and in close dialogue with the European Commission. The project task force will hand over a comprehensive set of exposure drafts to the newly established sustainability reporting pillar of EFRAG in readiness for public consultation before the end of April. A cost/benefit analysis will also be carried out on the initiative.

The Chair noted the importance of the sequencing for the adoption of the directive. A policy-maker explained that EFRAG is carrying out preparatory work, but ultimately the Commission decides whether to make this the law.

An industry representative stated that public policy must play a huge role in making decisions on some of the options that are open, and there has to be transparency about those decisions being taken, as well as the source of the authority and the extent of the authority being given, whether it is with standard-setting boards or regulators. The political process needs to be engaged in this as well to make sure that such decisions are being made democratically.

#### 3.4 The work of the International Sustainability Standards Board (ISSB)

An official confirmed that the ISSB is starting its own journey, but is building on some strong legacies. The technical readiness working group (TRWG) in the ISSB has been working hard on the issues, though its work has been simpler than EFRAG's because it focused on the general requirements prototype and the climate prototype.

The ISSB should only be a few weeks away from its exposure draft. Parallel to the EFRAG work, the ISSB will probably have a 90-day consultation. The ISSB continues to believe that with the ambition mentioned by International Organization of Securities Commissions (IOSCO) at COP26, it is feasible to have these first two standards ready for adoption at the end of this year.

#### 3.5 Double materiality complements single materiality

An official emphasised the importance of double materiality. Double materiality complements single materiality and does not replace it. The remit of the IFRS Foundation is about answering market participants' needs, and in particular investor needs which focus on enterprise value and the assessment of enterprise value.

#### 3.6 ISSB targets the definition of an interoperable principle-based global baseline

An official explained that the goal is to establish a comprehensive, global baseline of reliable, comparable, verifiable standards which any jurisdiction could either decide to apply on their own or build upon to bring more granularity and/or double materiality. What is important is interoperability. Avoiding divergence is going to be critical for the single materiality line on which IFRS will focus. There is a review of what are very ambitious scope and granularity levels for the climate requirements of the IFRS Foundation.

Regarding the taxonomy, as far as the IASB requirements that need to be adopted it is not for the ISSB or anyone in standard setting to say what is good, what is green, what is brown or what is black. The EU could have a position for a period of time, but that might change such that it cannot be accepted that global investors and global companies operate with something that is currently green, but which might become something else.

### 4. Defining interoperable non-financial reporting requires difficult political agreements at the global level

#### 4.1 Building transparent and interoperable reporting will require policy makers to answer challenging questions

An official explained that the taxonomy will have to be evaluated to ensure that investors and companies are available, with the energy mixes they have. That it is a principles-based exercise. For sustainability, that will

often have to be very granular to ensure there is neutrality.

The Chair noted that as the main source of funding for IFRS comes from the European Commission and the European member states it is hoped ISSB will maintain close contact with EFRAG and others to avoid duplication.

#### **4.2 Global interoperable standards will have to address regional specificities**

An industry representative emphasised convergence and the concern about having double reporting. Regarding interoperability, the task force of the ISSB just proposed a climate prototype, but this is mainly based on Sustainability Accounting Standards Board (SASB) references, which is very US-centric. The EU taxonomy is EU rules-based. The question is if they are going to work together to make sure that clients, companies and auditors will not have double reporting.

#### **4.3 Avoiding duplication requires pragmatism and accepting reasonable political ambitions**

An industry representative highlighted the need to avoid for large international corporates situations where multiple different sustainability reporting frameworks would apply, and remarked that one of the challenges is the complexity of the topic versus the urgency. There will need to be an iterative process, because the urgency requires having something good now rather than something perfect.

An industry representative remarked that something adequate rather than something good should probably be settled for currently. History shows it is very difficult, even in areas that are quite technical, to achieve convergence. It is even difficult with the same sort of words to achieve convergence in practice for how those words are interpreted.

With baselines that give a degree of transparency there will likely still be different reporting approaches, but at least if it is possible to pick and choose from a menu, which some countries will apply and others will not, then that is a starting point for achieving interoperability.

## **5. Political involvement is uneven for non-financial reporting**

### **5.1 In the EU, democratic accountability prevails**

An industry representative stated that ultimately Europe should not become subservient to the global. Solvency II provides a good example of the correct approach. Europe should be just be as sovereign as the US.

A policy-maker stated the legislators are sovereign. If the US legislator decides on things, that is their decision. It is nonetheless always good to talk to each other, which is what happens. There is regulatory dialogue with the US and these issues are put on the table. Each jurisdiction is accountable to its citizens for what it does and the decisions taken, but that does not mean that there is no attempt to find common ground where possible.

### **5.2 The level of political involvement in non-financial reporting is lower in the US than in the EU**

An official stated that the US is a very low-regulation country overall. It may be that in the US market adoption will be even more important for the global baseline. The SASB metrics are being used by thousands of companies in the US. They will need to be internationalised through the ISSB's work when consolidating the value reporting foundation. Europe has a very strong political process driving the work on these metrics, and that is very unlikely to be the case either now or in the short-term future in the US.

### **5.3 The ISSB anticipates an important role for market participants on standard setting**

An official noted that much will rely on market participants and industry associations. Sustainability topics will involve a broad set of co-construction and dialogues. To have the metrics adopted efficiently for all economic actors, repetition has to be avoided.

The constituencies to do this are being built. The equivalent of the Accounting Standards Advisory Forum of the IASB is being set up by the trustees of the foundation. The first working discussions started just a few weeks ago. The intention is to involve Europe, the US and other important jurisdictions, including emerging markets. The dialogue has to be conducted in a formal and transparent way with the jurisdictions to guide the work. The Chair noted that this is both a political issue and something that could be market led.

### **5.4 Non-financial reporting will provide many co-construction opportunities and reduce inconsistency**

An official added that to be pragmatic co-construction means trying to avoid multiple reporting. However, the criteria set down in legislation by the co-legislators on the basis of the proposal made by the CSRD have to be met. In co-construction dialogue, there is discussion and argumentation about the topics and how to approach them, but the conclusions are not necessarily the same. Compatibility is being worked on without surrendering key principles like double materiality.

An official stated that it would be very difficult for the IFRS Foundation to impose anything on any government around the world. Adoption is by jurisdiction.

### **5.5 Non-financial reporting standards should reduce the implications of regional specificities and foster interoperability**

An industry representative suggested that it does not matter if there are multiple standards if they all build on each other. It has to be possible for an entity to choose whether it is going to report on certain things, and it should be recognised that investment in certain countries is not going to be able to comply with everything that might be done when investing into a European company in two years' time. They have to be helped over time to reach the needed position. If Europe, the US or others have excellent ESG standards, while finance has not been enabled and facilitated to get to where it is needed most, all of the problems from a planetary perspective will not be solved.

An industry representative noted that specific and prescriptive standards are needed to avoid too much interpretation. An official stated that the building block approach works. Coordination is needed in the timing. The EU has a broad spectrum of sustainability matters which are to be reported on following the CSRD. There is a need to understand what the agenda of the ISSB will be.

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## **6. One challenge is the heterogeneity of the ISSB's and EFRAG's timetables**

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The Chair asked how long it will take to implement the directive. An official replied that co-legislators are currently discussing it. The initial implementation date, which was 2024 on the basis of reporting year 2023, is deemed by both co-legislators to be too ambitious.

The Chair remarked that climate change will not wait. An official accepted that, but time is needed to implement. Pragmatism and reliable data are needed.

An official suggested the ISSB's position is simpler as it does not have as broad and deep political responsibilities. The SEC is moving on climate and will also have a consultation. There will be an opportunity to have a very open view, including from market participants and others beyond the market. The ambition is to be able to propose to jurisdictions towards the end of this year the adoption of the global baseline on the general requirements.

A policy-maker stated that there will ultimately be a good co-construction product, both at international and European levels, taking into account all needs and looking into the global objectives that have to be fulfilled.

The Chair remarked that for an issue like climate, both public and private should not be opposed, but it should be light-touch work. The urgency and seriousness of the question of the climate should be appreciated, though it is not only about the climate. Standards should be adopted. The public side is playing its role, which is sometimes to make things mandatory. There are serious challenges ahead, and there has to be a move from a carbonised economy to something else. It is not going to happen if it is left to the market or maybe even if it is just left to politicians.