SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

Synopsis

Implementing a global baseline for corporate climate disclosures
Keynote address at IFRS Foundation Conference 2022

Mr Ashley Alder
Chief Executive Officer

23 June 2022

In a keynote address at the IFRS Foundation Conference 2022, Mr Ashley Alder related the key issues which the International Organization of Securities Commissions (IOSCO)[1] was considering as part of its in-depth technical evaluation of the International Sustainability Standards Board (ISSB) Exposure Drafts[2]. IOSCO placed considerable emphasis on the success of the ISSB project, and its evaluation was expected to inform IOSCO's potential endorsement of the final standards later in 2022 or early in 2023.

By endorsing the standards, IOSCO would signal to its large membership of market regulators that they should examine how they might adopt the standards in their own jurisdictions. The critical next step would be to consider the degree to which and how they can be adopted in practice, Mr Alder said.

Mr Alder then outlined the specific challenges to implementing the ISSB standards across vastly differing international settings. He expressed confidence that these challenges could be overcome to achieve for the ISSB standards what had been accomplished for the International Financial Reporting Standards (IFRS). IOSCO's endorsement of the international accounting standards in 2000 paved the way for its large membership of securities regulators to adopt them, or encourage others in their jurisdictions to adopt them, and that eventually led to the acceptance of IFRS in over 140 jurisdictions.

Mr Alder said he firmly believed the ISSB was the most credible mechanism for creating a baseline for climate disclosure standards, based on best practices and proven content, sourced from the most widely adopted frameworks and standards now in use. Converging the standard setters, as well as their standards, was the best option to integrate existing initiatives and stakeholder opinions on a single platform. That could enable a confusing, fragmented picture to be replaced by a properly aligned global approach.

The ISSB standards were of special relevance to securities regulators because they could provide vital information for the markets supervised by IOSCO members, Mr Alder emphasised. A consistent, systematic approach to the disclosure of climate risks was especially crucial to inform investors when making choices to allocate capital, to help align investment strategies with the global transition to net zero and to mitigate increasing greenwashing risks. In addition, the ISSB standards should help bridge the divide between

[1] Mr Alder is the Chair of the Board of IOSCO.
[2] "ISSB delivers proposals that create comprehensive global baseline of sustainability disclosures", 31 March 2022: https://www.ifrs.org/news-and-events/news/2022/03/issb-delivers-proposals-that-create-comprehensive-global-baseline-of-sustainability-disclosures.

traditional financial statements and sustainability reporting, as well as between traditional audit standards and independent assurance for sustainability reporting.

Greenwashing

A major motivation for securities regulators to support the ISSB project was to help stem greenwashing and build trust in sustainable finance, Mr Alder noted. The current fragmented sustainability reporting landscape deprived investors of consistent, comparable data, and this contributed hugely to greenwashing risks. Furthermore, worries about greenwashing had increased given the rush to embrace environmental, social and governance (ESG) objectives across the financial landscape and advertise net-zero commitments. Recent cases of investigations and fines were highlighted in the media, Mr Alder added, recalling a comment by Ignazio Visco, Governor of the Bank of Italy, who said that extreme concern around the rise of greenwashing raised questions about the sustainability of sustainable finance as a whole.

Path to IOSCO endorsement

Mr Alder next related the main criteria for IOSCO's technical evaluation of the ISSB Exposure Drafts: the ISSB standards should be compatible and connected with existing accounting and financial reporting standards—serving as a "bridge"; they should act as a common base for jurisdiction-level requirements, making them interoperable with one another using a building blocks approach, and they should provide the degree of consistency necessary to enable markets to reliably price sustainability-related risks and opportunities and support capital allocation. Finally, they should form the basis for the development of a credible assurance framework.

Interoperability is a crucial issue for market regulators, Mr Alder stressed. The ISSB standards should be capable of being implemented across jurisdictions, in both developed markets such as those in the US and EU, which were each developing standards of their own, as well as in developing markets. He added that they should be open standards which allow jurisdictions to build on the baseline to accommodate their own sustainability needs and circumstances, but, crucially, not allow such a degree of divergence that would undermine the project's intent.

Additionally, the baseline standards should be configured in a way which ensures that they could be adopted as mandatory rules if jurisdictions chose to take that route. Ultimately, the standards also needed to be sufficiently enforceable to allow regulators to hold corporates properly accountable.

In parallel, IOSCO is assessing its confidence in the standard-setting process, as distinct from the standards themselves. Mr Alder was confident that this process is underpinned by a governance structure centred on a technically-expert independent board and the overlay of the IFRS Foundation Trustees, who have a clear mandate to operate in the public interest. Moreover, that governance structure was ultimately accountable to global public sector authorities, who were represented by a Monitoring Board chaired by IOSCO. The Monitoring Board has been very active in overseeing the development of the ISSB standards from a public interest perspective.

Key challenges to implementation

Data

Mr Alder viewed that the first major challenge to the implementation of the ISSB standards boiled down to the availability—or unavailability—of the third-party or externally sourced data which was vital to inform meaningful disclosures. From IOSCO's perspective, this primarily related to quantitative climate disclosures, such as data or estimates for Scope 3 corporate value chain emissions. This data, unlike the data which normally informs conventional financial reporting, exists outside the company books.

In Asia, these data challenges present a significant obstacle to implementation. For example, the majority of companies listed in Hong Kong are mainland China businesses, so if Hong Kong introduces the ISSB standards, the required disclosures would be almost entirely dependent on data located in mainland China. The Securities and Futures Commission and the China Securities Regulatory Commission have set up a working group to deal with these challenges.

Mr Alder also raised the issue that ESG ratings had been hampered by subjectivity, lack of transparency and serious inconsistencies in methodologies. Asset managers struggled to accurately describe how they managed climate risks at both the firm and portfolio levels. IOSCO published two reports in 2021 detailing how asset managers and ESG ratings providers were expected to operate in order to minimise these problems. However, regulators' expectations could only be fully realised if two things were achieved: first, real economy corporate sustainably disclosures as envisaged by the ISSB and second, access to, and globally consistent interpretation of, the underlying data necessary to inform these disclosures. Only then would end-investors have justified confidence in the products and information offered to them.

Interoperability

The second consideration for IOSCO's assessment of the Exposure Drafts was their potential to provide a basis for jurisdiction-specific development, Mr Alder said. The Task Force on Climate-Related Financial Disclosures (TCFD) framework was the common source for the ISSB, Securities and Exchange Commission and EU proposals for corporate sustainability reporting, and from the beginning, the ISSB adopted a building blocks approach which gave jurisdictions flexibility to build on the global baseline and take local circumstances and considerations into account.

If the ISSB global baseline were to have a sufficient impact, Mr Alder pointed out, it must be adopted across Asia, which accounts for half of global greenhouse gas emissions and includes many of the countries where the effects of climate change would be disproportionately felt. However, domestic initiatives for climate reporting are not as advanced in Asia as in the EU, for example. This meant that the potential for the ISSB standards to be a major accelerant for globally consistent reporting was enormous.

Proportionality

Thirdly, proportionality was important to securities regulators because the readiness of companies to report in line with the ISSB standards would vary depending, for example, on a company's size, its industry sector and the jurisdiction. Small and medium enterprises (SMEs) may face special difficulties, as may larger companies dependent on complex supply networks in developing economies. There was therefore a real need to agree on the criteria for proportionate and phased implementation. And because jurisdiction-level approaches were bound to differ, it needed to be acknowledged that a period of transition was inevitable.

Some jurisdictions had started to look at how to scale and phase implementation, Mr Alder said. However, too much flexibility would undermine the rationale of the entire project, which was based on notions of standardisation and convergence. IOSCO believed any scaling and phasing should be limited and should not dilute the ambition of the standards. That implies that there should be guidance on implementation to ensure jurisdictional approaches are sufficiently consistent, and the ISSB might consider issuing supplemental implementation guidance to support preparers and promote consistent disclosures: basically a "how to" manual.

Mr Alder also suggested identifying specific areas such as Scope 3 greenhouse gas emissions where some limited flexibility for proportionate application might be considered for SMEs and emerging markets. He also suggested considering which disclosures might need more time to implement due to genuine data and capacity issues, or associated costs.

For those in Asia who were not too familiar with sustainability reporting, this would help them better understand and be able to report on core concepts such as materiality. This approach would also allow the ISSB to preserve the aspirations of the standards, while helping preparers to pursue a common approach to the real challenges they may face in moving to full implementation.

Audit and assurance

A credible, independent assurance framework would be key to instil trust in the quality of sustainability disclosures, Mr Alder continued. An IOSCO workstream dedicated to this difficult area is coordinating efforts by the International Auditing and Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA), which are both looking to accelerate the development of assurance standards for sustainability. That is a very welcome change of pace, and as a result IOSCO's work on assurance had accelerated as well.

Mr Alder emphasised that, compared to traditional audits, the information underpinning sustainability disclosures and other non-financial reporting may give rise to some novel challenges, including the treatment of forward-looking information, how to achieve assurance of estimates and external data outside a company's control, how to settle on the scope, coverage and completeness of disclosures and how to land on the level of assurance provided. IOSCO remained determined to play a lead coordinating role in this effort, and to inject urgency to allow us to confidently move to an era where mandatory disclosures become commonplace.

Linkages to financial statements

The relationship between sustainability disclosures and traditional financial statements had become increasingly important. The ISSB proposals made it clear that investors should be able to understand the linkages between the information in a company's traditional financial statements and the information in its sustainability disclosures. Broadly, the common objective was to end up with a single body of coherent information which was globally consistent, comparable and decision-useful. It should ideally capture how a company's financials, which mostly relate to the impact of past events, could be affected by sustainability risks and opportunities, especially climate.

Current accounting principles and standards mainly reflect a company's near-term risks and opportunities, but in reality, the resulting financial statements are what investors mainly look to when making decisions about valuation and pricing. Moreover, financial statements which are founded mainly in tangible, internal historic data or, when forward-looking, in data which gives a sufficient level of certainty, can be hard to correlate with sustainability disclosures. For one thing, they usually do not contemplate the impact of climate change, absent a known climate-related event for which the implications can be confidently anticipated or gauged, Mr Alder noted. However, climate-related risks, for example extreme weather events, may have a significant financial impact when they materialise, despite their perceived low likelihood. He cited recent examples which included the first climate-related bankruptcy, PG&E, major forest fires in Australia, flooding in China and Germany and the current heatwave in Europe.

The ISSB standards were intended to broaden the perspectives of preparers and extend the horizon along which non-financial risks and opportunities could affect future earnings and the ability to continue generating value for investors, hence the focus on enterprise value as a core concept. Mr Alder suggested that the ISSB should work closely with the International Accounting Standards Board (IASB) to consider how preparers could be encouraged to develop the factors relevant to calculating enterprise value from a quantitative perspective, and to consider how that calculation might connect to traditional financial statements. Arguably, there should be greater consistency in the assumptions used in both sets of standards, and more thought is needed to consider how ISSB reporting may lead to new approaches to impairments, provisioning and expected credit losses.

The overall aspiration is to bridge the divide between conventional financial disclosures and ISSB sustainability disclosures centred on the concept of enterprise value, so that in combination they paint the full picture. For that reason, more creativity is needed to identify connections between the outcome of the ISSB standards when it comes to information about enterprise value and how this relates to aspects of the conventional financial statements when it comes to the hard numbers.

Mr Alder stressed that he would not like to see an outcome where sustainability disclosures sat in their own ghetto, where they may be considered useful only by those who cared to take them into account. If that happened, the risk is that when making judgements around pricing and value, a large constituency of investors and analysts would continue to place more reliance on traditional financial statements, rather than on sustainability disclosures.