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Proposal for a corporate sustainability reporting directive. The way forward

Keynote speech by Jean-Paul Servais, Chairman FSMA and Vice Chair of the IOSCO Board

There is a broad consensus that, after the global financial crisis and the COVID crisis, climate change is the third major risk in this century to economic prosperity and financial resilience.

The financial markets are a part of the solution to ensure the financial system is resilient in the face of climate-related risks and to support the transition to a sustainable economy more generally.

For the actors in the financial markets to play their role, the disclosure of comprehensive and comparable sustainability-related disclosure is of paramount importance. Investors in particular, including asset managers, need such disclosure by companies in order to use them in their own risk management systems and to support reporting to their own clients.

Since there are currently wide data gaps, it is the role of public authorities to step in.

In this presentation, I will point out that public authorities at national, EU and international level have to work together on this task of improving corporate reporting. Even more than the COVID crisis, during which some countries such as New Zealand could isolate themselves, the climate crisis is an inherently global crisis. To cite the metaphor Mark Carney highlights in his most recent book “Value(s)”, we are all in the same storm, but also in the same boat.

Before addressing the importance of actions at EU and global level, I would like to illustrate the issue of data gaps in ESG reporting, drawing on a study in Belgium that the FSMA, the Belgian securities and markets regulator, conducted this year.

As the supervisor of the information disseminated by Belgian listed companies, the FSMA examined if a selected group of issuers met the requirements set out in the current NFRD (Non-Financial Reporting Directive). The study concludes that on several points the reporting quality is improving. For instance, reporting on environmental and personnel policies has improved measurably. On some other topics, there is still margin for improvement.

The study also identifies a number of more general recommendations to help companies improve the quality of their non-financial reporting and to avoid a scenario in which we see an ever increasing divide between the issuers who are best in class and continuously improve their reporting quality and the others who struggle to meet the required quality standards.

To this end, companies should clearly describe the risks they identify and make more use of the double materiality perspective in climate change matters. Furthermore, companies should strive to report material information in a balanced manner. This is in order to avoid greenwashing. In addition, there is a need to clearly define non-financial targets on a short-, mid- and long term basis as well as the associated KPIs that will make it possible to measure progress. More emphasis should also be placed on links between financial and non-financial information.

The Belgian study is a clear illustration of the Commission's findings that users' needs are not being met across the EU. As the chairman of a national regulator, I thus fully support the initiative of the EU Commission on a new corporate sustainability reporting directive. The Commission initiative is ambitious, covering all ESG factors that influence corporate behavior for the better. In so doing, the EC positions the EU as a global leader, as it is in many other areas, by creating a so-called "Brussels effect".

The future of sustainability reporting that provides insights into sustainability risks and opportunities also depends, in my view, on good international cooperation. That's why, in the next part of this presentation, I will address the global initiatives taken by the IFRS Foundation and by IOSCO, since I am personally involved in both, as vice chair of IOSCO and as chair of the IFRS Monitoring Board.

Michel Madelain explained earlier today why the IFRS Foundation got involved in sustainability reporting, and what are the expected features of its initiative: a new standard-setting board (International Sustainability Standards Board or “ISSB”) in addition to the IASB under the roof of the IFRS Foundation. The new ISSB will focus on climate-first corporate disclosures and will later extend to other areas that are of interest to investors and impact enterprise value. This initiative is being explored with the help of IOSCO, the global standard-setter for financial markets.

Why and how is IOSCO involved? First, because enterprise value reporting is part of its mandate to promote investor protection. IOSCO’s members – the world’s securities regulators - are interested in decision-useful investor-oriented corporate disclosure, be it financial or non-financial reporting. Securities regulators may be able to enforce sustainability reporting standards on a day-to-day basis in a way that is comparable to their existing monitoring of issuers’ financial statements. They can help prevent greenwashing by market participants in order to maintain trust in sustainable finance¹.

Secondly, IOSCO is involved because of its role in the oversight of the governance of the IFRS Foundation, largely through its role as chair of the organisation’s Monitoring Board, and as such will monitor the governance implications of the IFRS Trustees’ proposals on sustainability.

Thirdly, IOSCO can play a critical role in adding momentum to the IFRS initiative, given the urgent need to remedy the data gaps worldwide. The historic example is the endorsement IOSCO gave in 2000 to the IASB architecture and financial reporting standards. If the IFRS Foundation can set up the ISSB before COP26 in November 2021, I would expect IOSCO to be able to signal this year that it believes that the preparatory work on a new draft standard is the right basis for an endorsed standard. Once the standard is actually produced by the ISSB, IOSCO should be in a position to endorse it quickly. Such an endorsement could take place as soon as possible next year. It is clear that IOSCO’s support for this

¹ Companies often report sustainability-related information selectively, referencing different frameworks. This can lead to cherry-picking among reporting standards or ratings in order to make sustainability disclosures look as good as possible.

initiative would send a clear message to its members to start mandating the standards for use in their jurisdictions.

To be endorsed for adoption by IOSCO members, a standard has to be able to serve as a baseline for consistent and comparable approaches to mandatory sustainability-related disclosures across jurisdictions; it must be compatible with existing accounting reporting standards, promote good governance of sustainability disclosures among issuers, and form the basis for developing an audit and assurance framework.

Audit (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 met². As co-chair, on behalf of IOSCO, of the international Monitoring Group which monitors progress in developing international audit standards, I encourage the International Auditing and Assurance Standards Board (IAASB) and the audit profession to be agile in considering further integrating the sustainability aspect into auditing standards.

Importantly, IOSCO encourages a “building blocks” approach to establishing a global sustainability reporting system and limiting undue fragmentation as much as possible.

By working with standard-setters from key jurisdictions, the new IFRS sustainability board’s standards should provide a globally consistent and comparable sustainability-reporting baseline. The building blocks approach will allow jurisdictions to go further and faster if they wish, while retaining cross-border comparability.

² The above-mentioned FSMA study concluded that almost all auditors have checked whether companies included a non-financial statement and whether it was based on a European or international framework. The auditors did not, however, express an opinion on the quality of the content of the non-financial statement. Only a few companies voluntarily provide external assurance on the content of their non-financial statement. But when they do, the assurance often relates only to some specific elements of the statement. Reliability and quality assurance of the non-financial statements is crucial and remains an important area for improvement.

In this respect, I believe there is consistency between the IFRS/IOSCO approach and the EU's thinking on international cooperation. The EU cannot achieve the green transition alone. It needs other countries to share its ambition and work in the same direction. Greater international alignment on ESG-related disclosures will increase global transparency. It will also reduce the due-diligence costs for global investors and the administrative costs of companies operating globally.

EFRAG proposed earlier this year that the EU would promote and participate in global convergence efforts on a “co-construction” basis. The ultimate goal, as expressed by EFRAG, is to foster coherence and consistency between EU and global sustainability reporting. In my expectation, this is in line with IFRS/IOSCO's building blocks approach, since the latter recognizes that EU standards may go further where necessary to meet the EU's own ambitions and be consistent with the EU's legal framework.

I welcome that the Commission has clarified that

- the EU standards should aim to incorporate the essential elements of globally accepted standards currently being developed;
- the proposed EU sustainability reporting standards would build on and contribute to standardisation initiatives at global level and that this will require constructive two-way cooperation between EFRAG and relevant international initiatives.

If the EU legal proposals are agreed upon in the first half of 2022, the first set of reporting standards will be adopted at EU level by the end of 2022. The first IFRS standard is expected to be ready in mid-2022, and it can be noted that recital 37 of the draft Directive clarifies that “Standards of the European Union should take account of any sustainability reporting standards developed under the auspices of International Financial Reporting Standards Foundation”. As IFRS sustainability standards are expected to consolidate existing private initiatives, it is indeed in the interest of the EU legislator to pay due regard to such IFRS-led consolidation in order to facilitate the transition of issuers that already use existing standards.

It would be good if all regional initiatives were available to be part of global convergence efforts, so as to make convergence happen as quickly as possible. In this respect, the global consensus on the need to enhance disclosures spans among others the EU, the US³ and Asia and is a positive signal for the future. The same is true for the recent FSB statement to the G20⁴ welcoming the steps being taken by the IFRS Foundation, supported by IOSCO, to accelerate convergence in global sustainability reporting standards.

³ See, the declaration by US Treasury Secretary J. Yellen that the US authorities are closely following progress of, and support, the IFRS Foundation establishing a Sustainability Standards Board that will focus first on developing a climate disclosure standard (Remarks to the Institute of International Finance, 21 April 2021).

⁴ FSB Chair's letter to G20 Finance Ministers and Central Bank Governors, 6 April 2021.