COMMENT LETTER

December 31, 2020

ICI Response to IFRS Foundation's Consultation Paper on Sustainability Reporting (pdf)

IFRS Foundation Columbus Building 7 Westferry Circus Canary Wharf London E14 4HD United Kingdom Re: Consultation Paper on Sustainability Reporting Dear IFRS Foundation Trustee Members: The Investment Company Institute, including ICI Global,1 is writing to submit our responses to the questions in the IFRS Foundation's Consultation Paper on Sustainability Reporting.2 The consultation paper contemplates the creation of a sustainability standards board (SSB) under the governance structure of the IFRS Foundation to develop globally accepted sustainability reporting standards building on existing sustainability reporting frameworks. As the trade association representing regulated funds globally, ICI has a significant interest in how sustainability reporting standards for corporate issuers evolve.3 The development of these reporting standards, and their broad adoption, are critical for fund managers to have access to accurate, comparable, and comprehensive sustainability-related information. Fund managers use this information to pursue a range of investment strategies on behalf of the millions of retail investors around the world choosing funds to save for retirement, education, and other important financial goals. We agree with the IFRS Foundation's observation that 'there is an urgent need to improve the consistency and comparability of sustainability reporting.' Fund managers increasingly are seeking sustainability information from corporate issuers to inform their investment decisions. While some companies are making the effort to provide this information, the information often is too fragmented, inconsistent, or incomplete due in part to competing disclosure frameworks. A strong, global framework that guides companies on what sustainability information to disclose, and how to disclose 1 The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$25.8 trillion in the United States, serving more than 100 million US shareholders, and US$8.3 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC. 2 The consultation is available at https://cdn.ifrs.org/-/media/project/sustainability-reporting/consultation-paper-on-sustainability-reporting.pdf?la=en%20 (IFRS Consultation). 3 We use the terms, 'company,' 'issuer,' and 'corporate issuer' interchangeably in this letter to refer to the entities providing sustainability disclosures. 31 December 2020 Page 2 of 7 it, can help ensure investors have information—prepared on a consistent and comparable basis—to inform investment decisions and help efficiently allocate capital.4 We believe the IFRS Foundation could advance globally accepted sustainability reporting standards, provided that the IFRS Foundation's SSB initiative incorporates the following five essential requirements for success:5 1. Focus on sustainability information that is not reflected in the financial accounts, but which is nevertheless material to enterprise value creation over the short, medium, and long term.6 2. Leverage existing global sustainability standards that have broad investor support, particularly the Sustainability Accounting Standards Board (SASB) and the Task Force on Climate-related Financial Disclosures (TCFD). 3. Develop a governance structure that appropriately represents the interests of investors. 4. Create a balanced funding model to ensure an SSB's independence and avoid undue influence of third parties and conflicts of interest. 5. Ensure sufficient coordination among international regulators to facilitate cohesive baseline disclosure of sustainability information that is material to enterprise value creation. We explain each of these elements in further detail below. We also explain our views on why mandatory third-party assurance would be premature, although we support future consideration of assurance in developing any SSB sustainability reporting standards.7 4 Throughout this letter we use the term 'investors' to refer to fund managers and other providers of equity and debt capital. Any sustainability standards should recognize the information needs of these investors. 5 Question 1 asks if there is a need for a global set of internationally recognized sustainability reporting standards and, if yes, whether the IFRS Foundation should play a role in setting these standards. Question 3 asks for any comments or suggested additions on the requirements for success as listed in paragraph 31. 6 The Sustainability Accounting Standards Board (SASB) describes financially material sustainability issues as those that are material to the creation of enterprise value over the short, medium, and long term—i.e., the issues that are reasonably likely to impact the financial condition or operating performance of a company and therefore are most important to investors. See SASB's Response to the IFRS Foundation's Consultation Paper on Sustainability Reporting, dated 11 December 2020, available at http://eifrs.ifrs.org/eifrs/comment_letters//570/570_27198_SonalDalalSustainabilityAccountingStandardsBoard_0_SAS BResponsetoIFRSConsultation11Dec2020.pdf. See also SASB website, 'Why is Financial Materiality important?' available at https://www.sasb.org/standards-overview/materiality-map/. 7 Question 10 asks whether the sustainability information to be disclosed should be auditable or subject to external assurance; and, if not, what different types of assurance would be acceptable for the information disclosed to be reliable and decision-useful. 31 December 2020 Page 3 of 7 A. Five Essential Requirements for Success 1. Focus on sustainability information that is not reflected in the financial accounts, but which is nevertheless material to enterprise value creation over the short, medium, and long term. We agree with the consultation paper's proposed approach to materiality, which would initially focus on the sustainability information most relevant to investors and other market participants.8 IFRS Standards are based on the concept of financial materiality, which implies focusing on information which—if omitted—could influence the decisions of investors or other users of the financial statements who are interested in the performance and long-term health of the reporting entity.9 We strongly support an SSB applying that same financial materiality lens to sustainability information and seeking to develop a structure and culture that builds effective synergies with financial reporting.10 This means an SSB seeking to provide investors with sustainability information that is not reflected in a company's financial statements but is nevertheless material for enterprise value creation.11 Doing so would provide investors with information to consider in making investment decisions and help efficiently allocate capital. While we acknowledge interest in also measuring the sustainability impact of a company (often referred to as 'double materiality'), we strongly caution that financial materiality and double materiality are two very different and distinct analytical lenses, serving different objectives and different sets of stakeholders. The financial materiality perspective looks 'outside-in' at the impact of sustainability factors on a company's business with a focus on meeting the information needs of investors and other providers of financial capital.12 In contrast, the double materiality perspective looks 'inside-out' at a company's impact on environmental and social sustainability with a much broader set of stakeholders and a more diffuse set of information needs.13 Information such as a 8 Question 9 asks whether respondents agree with the proposed approach to materiality in paragraph 50 that could be taken by the SSB. 9 See IFRS Consultation, supra note 2, at paragraph 46. 10 As the consultation paper states, this approach would more closely connect with the current focus of the International Accounting Standards Board (IASB). 11 See Statement of Intent to Work Together Towards Comprehensive Corporate Reporting (September 2020), available at https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work- Together-Towards-Comprehensive-Corporate-Reporting.pdf. 12 Although not all sustainability impacts are financially material, SASB and other sustainability disclosure standard setters have recognized that sustainability impacts considered immaterial to enterprise value creation today may become material over time. Movement of information back and forth along this continuum—from sustainability impact to material sustainability information to information that is reflected in a company's financial accounts could happen either gradually or rapidly due to catalyst events, stakeholder reaction, and regulatory reaction as well as innovation. See Statement of Intent to Work Together Towards Comprehensive Corporate Reporting (September 2020), available at https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work- Together-Towards-Comprehensive-Corporate-Reporting.pdf. 13 See IFRS Consultation, supra note 2, at paragraph 48, citing European Commission, Guidelines on reporting climate- related information, at p. 6-7, available at https://cdn.ifrs.org/-/media/project/sustainability-reporting/consultation-paper- on-sustainability-reporting.pdf?la=en%20. 31 December 2020 Page 4 of 7 company's carbon footprint may have implications from both the 'outside-in' and 'inside-out,' perspectives, but the two lenses are not one and the same. We reiterate that any SSB efforts should focus on the financial materiality lens. To be successful, a global standard must be based on where there is global consensus. We believe there can be a global consensus around a financial materiality approach, but not, in the foreseeable future, one around double materiality. Jurisdictions naturally will not agree on the same approach to double materiality as the double materiality perspective reflects each jurisdiction's unique and distinctive public policy objectives. For the foregoing reasons, we strongly support an SSB applying a financial materiality lens to sustainability information, with the objective of providing investors with sustainability information that is not reflected in a company's financial statements, but is nevertheless material for enterprise value creation. 2. Leverage existing global sustainability standards that have broad investor support, particularly SASB and TCFD. We applaud the IFRS Foundation for recognizing the importance of building on the established work of major standard setters.14 In order to meet its objectives of improving comparability and reducing complexity, the IFRS Foundation will need to build on existing disclosure frameworks that are well- recognized and offer global consistency, rather than creating yet another separate standard with its own unique requirements. Many of these frameworks are already widely used, and companies and investors alike have deep familiarity with their requirements. The IFRS Foundation should look first to SASB and TCFD. These sustainability frameworks are well-developed and have broad support in the financial markets.15 SASB has spent a considerable amount of time, with extensive investor input, developing an industry- specific disclosure framework for financially material sustainability information that affects issuers' businesses, including climate-related risk. Given the detail of the SASB framework and investors' significant contribution to its development, we strongly encourage an SSB to consider contracting with SASB to leverage its work more directly. The SASB framework includes a set of 77 industry-specific standards that identify the minimal set of financially material sustainability information and associated metrics for the typical company in an industry. This approach recognizes that a particular sustainability risk may be material to one issuer but not material to another depending on various factors, including the relevance of the information to the industry in which the company operates and the potential impact on the issuer. 14 Question 5 asks how the IFRS Foundation could best build upon and work with the existing initiatives in sustainability reporting to achieve further global consistency. 15 ICI's Board of Governors, for example, has expressed unanimous support for the use of the SASB and TCFD disclosure frameworks. See Press Release: ICI Board Unanimously Calls for Enhanced ESG Disclosure by Corporate Issuers (7 December 2020), available at https://www.ici.org/pressroom/news/20_news_esg. 31 December 2020 Page 5 of 7 An industry-specific approach also recognizes that, for certain industries or companies, other sustainability factors may be more relevant than climate risk.16 The consultation proposes to focus initially on climate-related risk. While we agree that climate risk is important, a global framework should consider a broad range of sustainability factors beyond climate.17 We similarly urge the IFRS Foundation to leverage the TCFD's recommendations on climate-related disclosures. The TCFD recommendations more narrowly focus on material climate-related disclosures with a principles-based framework that allows for broad application. More specifically, the TCFD guides companies to provide disclosure related to: governance around climate-related risks and opportunities; actual and potential impacts of climate-related risks and opportunities on the company's businesses, strategy, and financial planning, where such information is material; means by which the company identifies, assesses, and manages climate-related risks and how these are integrated into an overall risk management framework; and metrics and targets used to assess and manage relevant climate-related risk and opportunities, where such information is material. Many financial services regulators have expressed support for the TCFD and are adopting disclosure requirements aligned with the TCFD recommendations.18 This presents a potential opportunity for any SSB efforts to assist in creating comparability across TCFD-related disclosure requirements in different jurisdictions.19 3. Develop a governance structure that appropriately represents the interests of investors. We strongly agree that ensuring the adequacy of the governance structure is a requirement for success.20 The consultation proposes that the SSB would operate under the three-tier governance structure of the IFRS Foundation with an independent standard-setting board of experts, governed and overseen by the Foundation Trustees, which are accountable to the IFRS Foundation Monitoring Board. It is absolutely essential for the governance structure to focus on gathering input from investors as the primary users and from issuers as the primary sources of sustainability disclosure. Investors with 16 Question 8 asks if an SSB should have a focused definition of climate-related risks or consider broader environmental factors. 17 Question 7 asks, if the IFRS Foundation were to establish an SSB, whether it should initially develop climate-related financial disclosures before potentially broadening its remit into other areas of sustainability reporting. 18 See TCFD website at https://www.fsb-tcfd.org/supporters/sectors/government/. See also FSB response to the IFRS Foundation's Consultation Paper on Sustainability Reporting, dated 22 December 2020, available at https://www.fsb.org/wp-content/uploads/Response-to-IFRS-public-consultation-publication.pdf. 19 Question 6 asks how the IFRS Foundation could best build upon and work with the existing jurisdictional initiatives to find a global solution for consistent sustainability reporting. 20 Question 3 asks for any comments or suggested additions on the requirements for success as listed in paragraph 31 (including ensuring the adequacy of the governance structure). 31 December 2020 Page 6 of 7 experience using sustainability information to make investment decisions must have meaningful representation on an SSB and among the Foundation Trustees. Specifically, we recommend that the IFRS Foundation take the following actions: 1) Dedicate a significant portion of board seats on a new SSB to investor representation. The issuer and auditor constituencies also should be represented (our comments on third- party assurance of sustainability disclosures appear below) on the board of experts; 2) Establish an Investor Advisory Committee, following the IASB and SASB models, that meets with the SSB periodically and provides input on its agenda and standard-setting approach; and 3) Ensure that those investor representatives serving in the SSB have experience in using sustainability information for investment decision-making. The IFRS Foundation's perspective on an SSB's technical expertise is another area where an investor focus is paramount. The consultation paper states that an SSB would need to achieve appropriate technical expertise for the Trustees, SSB members, and staff. The paper also notes that an SSB would require a broad range of skills that are different than those of the IASB, including how to measure, not just report, on sustainability. We caution, however, that a sustainability expert may not necessarily be an expert in what information an investor identifies as material to enterprise value creation. Therefore, we urge the IFRS Foundation to focus on technical expertise from the perspective of investors who already have significant experience in requesting, obtaining, and analyzing a full range of company information, including sustainability information. 4. Create a balanced funding model to ensure an SSB's independence and avoid undue influence of third parties and conflicts of interest. We strongly agree that achieving the level of separate funding required and the capacity to obtain financial support is an essential requirement for success.21 An SSB must have a stable funding source that does not divert funding from the IASB and does not require continual fundraising. In addition, it is critical that any SSB funding model is balanced to ensure independence and avoid even the appearance of undue influence or conflicts of interest. We have particular concerns about an SSB receiving significant funding from service providers such as audit firms, which stand to benefit from providing various services on issuer disclosures. We also believe any SSB standards must be developed in a manner that is independent of political pressure. We therefore urge the IFRS Foundation to pursue funding from a balanced and broad set of market participants, including companies, investors, regulators, and service providers. A balanced mix of funders will minimize real or perceived conflicts of interest. 21 Question 3 asks for any comments or suggested additions on the requirements for success as listed in paragraph 31 (including on the requirements for achieving a sufficient level of funding). 31 December 2020 Page 7 of 7 5. Ensure sufficient coordination among international regulators to facilitate cohesive baseline disclosure of sustainability information that is material to enterprise value creation. Given the crowded field of policy initiatives in this space, regulatory coordination is essential for the success of any global disclosure standard. Support from the International Organization of Securities Commissions (IOSCO) and its members will be key.22 With the objective of providing investors with sustainability information that is material for enterprise value creation, an SSB can work to develop a global baseline of consistent, comparable information that serves as a foundation for jurisdictional initiatives.23 Such a baseline will increase comparability and reduce complexity and will not slow or undermine different jurisdictional initiatives that may build from this foundation. B. Third-Party Assurance Is Premature Given the developing state of sustainability standards and related issuer disclosures, conditions are not yet ripe for mandatory third-party assurance. We support future consideration of assurance, however, in developing any SSB sustainability reporting standards.24 This will ensure that any required disclosures can be subjected to third-party assurance once the standards have matured and the cost- benefit dynamics are favorable. ********** We appreciate the opportunity to provide feedback on the IFRS Foundation's proposal. If you have any questions, please contact me at eric.pan@ici.org or +1 202 326 5824. Sincerely, /s/ Eric J. Pan President & CEO Investment Company Institute 22 See IOSCO response to the IFRS Foundation Consultation on Sustainability Reporting, dated 23 December 2020, available at http://eifrs.ifrs.org/eifrs/comment_letters//570/570_27480_JonathanBravoInternationalOrganizationofSecuritiesComm issionsIOSCO_0_IOSCOcommentlettertoIFRSConsultationPaperonSustainabilityReporting.pdf (noting the importance of appropriate governance arrangements). 23 Question 6 asks how the IFRS Foundation could best build upon and work with the existing jurisdictional initiatives to find a global solution for consistent sustainability reporting. 24 Question 10 asks whether the sustainability information to be disclosed should be auditable or subject to external assurance; and, if not, what different types of assurance would be acceptable for the information disclosed to be reliable and decision-useful.
