Global Research & Analytics

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Hint of consensus in ESG reporting standard

Point of view

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Big Four converge on ESG reporting framework

The Big Four accounting firms – Deloitte, EY, KPMG and PwC – along with the World Economic Forum's International Business Council (IBC; headed by Bryan Moynihan, Chairman and CEO of Bank of America) unveiled a joint reporting framework for environmental, social and governance (ESG) standards in September 2020.

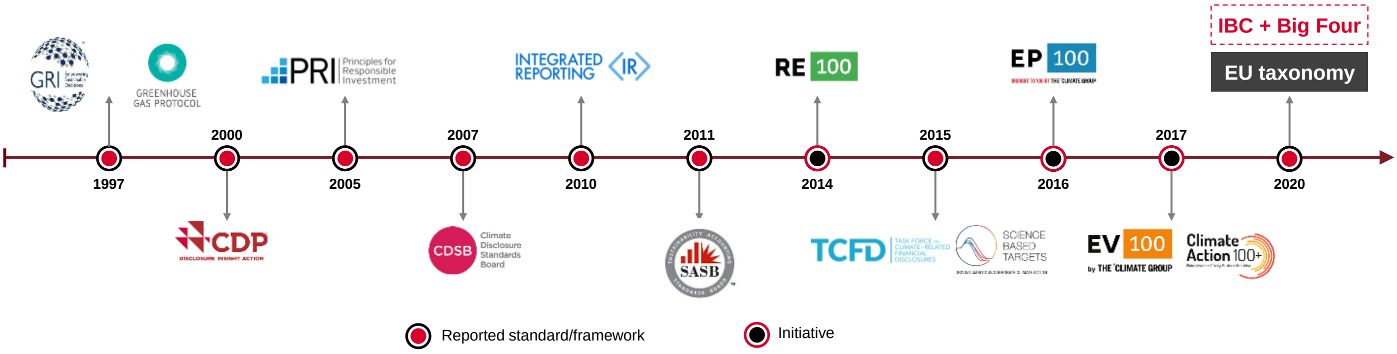
The sustainability reporting landscape is already crowded with multiple frameworks. Besides their large number, challenges persist in implementation across industries and jurisdictions, hindering data consistency and quality. While collaborative efforts have been underway, a 'one size fits all' standard has remained elusive.

The Big Four's new reporting standards is a first of its kind major move that provides the minimum disclosure requirements for a set of universal core metrics. Their backing provides much-needed credibility to data consistency and quality. This framework could evolve into a good consensus but global regulators have to quickly move towards an accepted common framework. However, even when enforced globally, challenges around financial materiality, climate change, and supply-chain impact assessment will need to be addressed.

Plethora of reporting standards

Currently, sustainability reporting is done through a multitude of frameworks, each laying emphasis on a different aspect. While the Global Reporting Initiative (GRI), International Integrated Reporting Council (IIRC) and Sustainability Accounting Standards Board (SASB) are holistic frameworks, the Task Force on Climate-related Financial Disclosures (TCFD) and Carbon Disclosure Project (CDP) lay more focus on climate risks. The upcoming EU taxonomy also focuses on environment with limited overlay of social and governance factors.

Timelines of major sustainability commitments



Source: Bloomberg NEF, CRISIL GR&A

The presence of a raft of voluntary disclosure regimes has led to the unintended consequence of confusion in the market place and among companies, between 'material' and 'greenwashing' metrics. Regulators have been monitoring the developments and are in discussion with stakeholders to address these issues.

- The European Union (EU) has been at the forefront of regulating sustainability disclosure. The EU taxonomy regulation provides much-needed boost to standardise sustainability disclosures in the region, as it is likely to apply to over 7,000 listed companies, banks and insurers. The first phase of taxonomy implementation has been delayed by a year and will most likely come into effect in 2022
- In the US, the Securities and Exchange Commission (SEC) has become active on the ESG front. In 2019, they sought details on ESG recommendations, methodologies and stewardship activities from managers. Separately, larger investors such as Blackrock and State Street have requested firms to disclose in accordance with SASB
- Regulations in Asia-Pacific are still at a nascent stage. Regulators in developed financial regimes (Hong Kong, Singapore and Japan) have been strengthening their stewardship and disclosure norms. For instance, HKEX has been promoting voluntary disclosure practice since 2013. Its most recent amendment, effective July 2020, mandates disclosure of relevant environmental targets and voluntary disclosure of social key performance indicators on 'comply or explain' basis, and mandatory statement on board's consideration of ESG matters.

Standardisation has been a long time coming

The absence of a standardised, universal framework for ESG reporting has been the biggest concern among stakeholders. This has hindered growth of sustainable investing because firms have no means to compare sustainability performance across companies, sectors and geographies. Recognising this, a number of collaborative efforts have been initiated between standard setters, industry organisations and regulators.

The Corporate Reporting Dialogue (CRD) is one such platform convened by the International Reporting Council in collaboration with standard setters such as SASB, GRI, CDP, IIRC and Climate Disclosure Standards Board (CDSB). The Better Alignment Project was started in 2018 to assess alignment with TCFD. Its findings suggest that 80% of the TCFD's 50 metrics were fully or reasonably covered by the GRI, SASB and CDP. Despite the overlap, CDP indicated that the global solution remained a challenge.

Collaborative efforts have gained traction in 2020. SASB and GRI announced a collaboration in July 2020 to provide guidance on how the two sets of standards could be used together for sustainability reporting. Similarly, in September 2020, GRI, SASB, TCFD and CDP have pledged to work with The International Organization of Securities Commissions (IOSCO) to develop a comprehensive corporate reporting system. The report is expected by October 2021. The International Financial Reporting Standards Foundation (IFRS) foundation also launched a consultation in September 2020 to assess the demand and contribute towards the development of global sustainability standards.

The Big Four standard could be a good consensus candidate to start with

The ESG reporting standard backed by the Big Four is also a collaborative effort. The proposal to develop a standard set of ESG metrics was made in January 2020. The approach of the Big Four is based on four pillars - governance, planet, people, and prosperity. It draws upon themes for each pillar based on existing standards such as those of GRI, SASB and TCFD. The Big Four standard comprises 22 core metrics, most of which are already being reported by many firms. The framework also encourages companies to report expanded metrics – though not mandatorily.

Thus, the framework presents a good consensus candidate. For companies that are looking to adopt sustainability disclosures, the universal approach enables ease of adoption. For companies adopting existing standards, migration should be smooth given the high overlap. The core metrics, have 82% and 27% overlap, respectively, with the existing GRI/SASB framework. Overall metrics (core + expanded) have 50% and 21% overlap, respectively.

Metrics overlap(#)	Pillars of the framework				Overall framework (no of metrics / % overlap)
	Governance	Planet	People	Prosperity	
Core metrics (no)	**6**	**4**	**6**	**6**	**22 (100%)**
GRI	**5**	**3**	**6**	**4**	**18 (82%)**
SASB	**1**	**3**	**2**	**0**	**6 (27%)**
TCFD	0	1	0	0	1 (5%)
ISO	0	0	0	0	0 (0%)
NCP	0	0	0	0	0 (0%)
Others	2	4	0	2	8 (36%)
Core + expanded (no)	**13**	**16**	**14**	**13**	**56 (100%)**
GRI	**7**	**5**	**9**	**7**	**28 (50%)**
SASB	**2**	**4**	**4**	**2**	**12 (21%)**
TCFD	0	2	0	0	2 (4%)
ISO	0	6	0	0	6 (11%)
NCP	0	6	0	0	6 (11%)
Others	7	7	7	5	26 (46%)

Note: Others include: EPIC, Colin Mayers, CDP, IAS, CDSB, OECD, SAM, SBTi, WDI, WBCSD & KPMG Circular Transition Indicators, MIT Living Wage Tool, Shift, UNPRI, Safe Work Australia, WBCSD Impact Framework, UN, CECP 2020, Reichheld, HBR, Bain & Company and Satmetrix

Source: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation Consultation Draft, CRISIL GR&A

Shadow enforcement to accelerate harmonisation and improve ESG data quality

The proposed framework with the backing of the Big Four accounting firms will be a credible guidepost for companies, regulators and investors. The role of the Big Four auditors will improve enforcement and partially bridge the reporting gap between financial and non-financial metrics.

- **Big Four role will accelerate adoption, thus driving data availability:** Unlike other collaborative efforts, the proposed ESG standard has the backing of the largest accounting firms, which have a strong market presence and global footprint. This should accelerate adoption across jurisdictions, including regions that have lagged in sustainability disclosures. The framework will enhance sustainable data availability, thus enabling investors to compare performances across industries and regions
- **Auditor oversight to provide much needed data assurance:** The role of the Big Four will not be restricted to driving wide adoption of its framework. The auditor oversight of the sustainable standard implementation will drive consistent and accurate disclosure and provide the much-needed third-party assurance on data quality. This was for long viewed to be a significant gap for investors in adopting sustainable process
- **Alignment with financial reporting to improve credibility:** The standard recommends publishing of non-financial data in tandem with financial data. That should ensure both metrics are considered in equal measure by managements, lending credibility to non-financial disclosures.

Global regulators need to quickly move towards an accepted common framework

The existing popular standards such as GRI, SASB and TCFD serve their purposes but they are still too many and create unwarranted confusion among corporates and investors. Regulators need to proactively arrive at a consensus and move towards a globally accepted singular minimum framework.

- **Need for global regulatory dialogue to address the 'multiple frameworks problem':** Regulation will be a key driver of the ESG wave given the landscape is affected by inconsistent disclosure, greenwashing and incorrect nomenclature. While Europe has been ahead on ESG regulations, regulatory action has been relatively slow in the US and the Asia-Pacific. It is critical that regulators in non-EU regimes to follow suit and focus on overseeing sustainability disclosures. They need to arrive at a consensus quickly because ESG investing is already steaming ahead, even as regulations and frameworks are lagging. This is hindering full ESG integration across the investment value chain and meeting expectations of asset owners
- **Big Four ESG standard could be a good voluntary framework for US firms**: A number of ESG disclosure standards have been developed and some incorporated into mandatory reporting regimes by non-US regulators (such as the EU taxonomy, which is non-binding on non-EU financial market participants). However, implementation by a US company remains voluntary. With the SEC contemplating mandated ESG disclosure, the Big Four ESG framework could prove to be ideal, given it predominantly uses the GRI standard, which is used by 51% of S&P500 companies. The market presence of Big Four in the US (495 companies in S&P 500 use one of the Big Four auditors) should further support the adoption
- **A viable universal framework that regulators can introduce in emerging markets**: Companies in emerging markets have started to embrace the concept of sustainability and are actively seeking to integrate it in their disclosure. But some frameworks do not accommodate jurisdictional and regional differences. For instance, it might not be feasible for companies in emerging markets to adhere to the classification of economic activities and thresholds set by EU taxonomy. The Big Four standard promises to be a universal framework that could be adopted by firms across jurisdictions and industries. This could be a good starting point for regulators in emerging markets that are considering mandating sustainability disclosures.

Even if enforced globally, challenges around materiality data, climate change, and supply-chain assessment will continue

The ongoing collaboration between standard setters and regulators will resolve the issue of missing ESG data to some extent. However, the proposed framework is unlikely to be a one-size-fits-all solution and has its own drawbacks. Investors will continue to face challenges over access to a wide breadth of ESG disclosures required for assessing material risks related to specific sectors and climate change. There needs to be intense collaboration with framework setters such as SASB and TCFD to enhance usefulness for investors.

- **Investors will continue to face missing-data issues:** The Big Four ESG standards in its current form do not accommodate industry-specific sustainability risks. While it would help investors compare companies across industries, peer comparison among similar industries would lack the granularity that SASB provides. For e.g., SASB specifically captures the number of US Food and Drug Administration enforcement actions for the pharma industry. We notice only 27% and 18% overlap of core and expanded metrics, respectively, with SASB measures. Hence we continue to see asset managers seeking to plug gaps in disclosure of material ESG metrics using proxy metrics and secondary data sources
- **Framework has limited overlap with climate related disclosure:** Climate risk remains a focus area for regulators and investors. The first phase of EU taxonomy focuses on climate adaptation and mitigation. There is also a recent guidance by the Commodity Futures Trading Commission (CFTC) subcommittee that urges CFTC and SEC to measure, understand, and address financial risks spawned by climate change. However, the proposed framework does not adequately cover climate risk-related metrics; it has limited overlap with TCFD metrics which is generally the go-to framework of investors for climate risks
- **Value chain impact assessment will be constrained as disclosure are not mandatory**: The scope of disclosures related to value-chain impact (e.g., Scope 3 emissions) is restricted to the set of expanded metrics, which is not mandated in the framework. It is unlikely that many firms would disclose those metrics given the investment, resources and effort required to capture them. In the absence of expanded metrics, environment impact assessment may not capture the indirect and value-chain impact on sustainability risk and this could be significant for certain sectors such as industry, buildings and agriculture.

Snapshot of key sustainability standards, frameworks and taxonomy

	Scope and target audience	Key elements
GRI	• Formed in 1997. Broader in scope. Outward looking, facilitate reporting on their economic, environmental and social performance • Caters to a wide variety of global stakeholders	• Qualitative and quantitative ESG disclosures • General and specific for some sectors. Cover multiple SDGs • Around 150 metrics covering: (1) 30-40 environment; (2) 30-40 social; and (3) 50-70 general and governance disclosure
SASB	• The SASB was set up in 2011. Inward looking, facilitating disclosures of material sustainability • Easy for investors to understand the impact of ESG risk on financial performance • The SASB's Investor Advisory Group represents $30 trillion of AUM	• Quantitative metrics for material ESG topics • SASB standards, available for 79 industries • Cover multiple SDGs • ESG metrics: 26 metrics (varies across industries); environment – 6; social & human – 10; business model – 5; governance - 5
TCFD	• Established in 2015 by the Financial Stability Board (FSB). A market-driven initiative to develop voluntary climate-related disclosures • Aimed at guiding investors, lenders and public stakeholders through mainstream filings	• Financial impacts of climate-related risks • Physical, liability and transition risks linked to climate change
CDSB	• The CDSB was founded in 2007 by an international consortium of business and environmental NGOs to set a framework to report environmental and climate change	• Environmental information with the same rigour as financial information
CDP	• The CDP is an UK organisation set up in 20oo. It supports disclosure of environmental impact by corporates	• The CDP focuses on climate change, water security and deforestation
SDG	• The goals of the SDG, launched in 2015, consist of a broad set of development goals and targets to be achieved by the whole world by 2030	• Climate change mitigation and adaptation • Sustainable use of water and resources
IIRC	• Formed in 2010 to create a global framework for companies to communicate their value creation • Global coalition of regulators, investors, companies, standard setters, the accounting profession, academia and NGOs	• Strategic focus and future orientation • Materiality that affect organisations' ability to create value
Big Four	• Formed in 2020 by World Economic Forum's IBC in collaboration with the Big Four • IBC members to use these metrics to align their mainstream reporting	• Universal framework for all industries • Provision for minimum requirement to adopt core metrics; voluntary for expanded metrics • Core metrics: 22 (governance – 6; planet – 4; people – 6; prosperity – 6) • Expanded metrics: 34 (governance – 7; planet – 12; people – 8; prosperity – 7)

Source: CRISIL GR&A

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