White paper

ISSB standards – the end of greenwashing?

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Current sustainable disclosure requirements

TCFD Task Force on Climate Related Financial Disclosures

Sustainable investment has become a hot topic over the last decade. As an investment consideration it is high on most, if not all, investors' concerns. However, reporting on sustainability performance has been an evolving process.

Mandatory sustainability disclosure requirements are in the process of being introduced by regulators in many of the main investment hubs. In the UK, TCFD-aligned disclosures became mandatory for publicly listed businesses from April 2022, with over 1,300 of the largest UK-registered companies and financial institutions being required to disclose climate-related financial information annually going forward. Japan and New Zealand have also mandated TCDF reporting.

In March 2022, the Securities and Exchange Commission (SEC) in the United States unveiled proposed regulations that would require companies to disclose their greenhouse gas emissions, as well as their exposure to climate-related risks. In addition, authorities in several regions including the European Union, Brazil, and Singapore have proposed mandatory TCFD disclosures for certain sectors.

Need for standardised reporting

Despite growing requirements for self-reporting, there is a lack of standardisation around what should be included in reporting. There are numerous reputable rating agencies and reporting frameworks, and the different bodies measure different aspects and provide scorings and ratings based on different criteria.

The inconsistencies have led to mismatches in the way that investments can appear, compared to their actual sustainability performance. This means that two companies with very similar sustainability credentials could appear to external investors with very different risk profiles – purely because of their reporting.

This disconnect, whether intentional or not, is leading to increasing scepticism in the marketplace. Terms such as “ESG backlash” and “greenwashing” are becoming common parlance as investors start to focus on the sustainability aspects of their investments. This so-called greenwashing makes it difficult for investors and stakeholders to accurately understand and evaluate the risks and value of what they are investing in.

More importantly, the lack of clear and comparable performance reporting has meant that sustainability assessments are being downgraded to a check box-exercise in an investment process rather than being the driver for change which really moves the needle.

Overleaf we present two case studies that illustrate some of the issues associated with current sustainability reporting and ratings.

This lack of consistent reporting has been an issue for many years and, to some extent, is inevitable in such a rapidly evolving industry. However, standardisation is now becoming a critical need.

Case study 1
Neptune Energy

UK-based private equity backed international oil and gas exploration and production company.

Prior to 2020, Neptune was not signed up to any of the established sustainability reporting standards.

It ranked as severe in Sustainalytics risk ratings. In 2020 Neptune made its first TCFD disclosure. As a result, its ESG risk rating improved from Severe to Medium. Sustainalytics risk ratings:

- 2019 – 46.9 Severe
- 2020 – 26.1 Medium
- 2021 – 23.4 Medium

This illustrated the potential value of 'official' standards. It also illustrates how sustainability ratings are about 'how' and 'what' information is reported as much as they are about the company's actions and performance.

Case study 2
Tesla

US multinational automotive and clean energy company. Designs and manufactures electric vehicles and other energy products.

Despite being a company that produces vehicles that provide environmental benefits, Tesla generally fall short in sustainability ratings.

This is due to risks around social aspects.

Specifically, human rights issues with suppliers and safety concerns around its recent autonomous vehicle testing. These risks led to the removal of Tesla from the S&P 500 ESG Index earlier this year.

This highlights the implications of considering all sustainability factors (environment, social and governance), as well as supply chains when publishing ratings.

Proposed ISSB standards

One of the key themes amongst the investor community at COP26 (in 2020) was the need for a level playing field. To address these concerns the International Sustainability Standards Board (ISSB) was set up.

The ISSB is part of the UK based International Financial Reporting Standard (IFRS) Foundation. ISSB was established to: develop a comprehensive global baseline of sustainability disclosures.

In March 2022, ISSB issued a set of standards for consultation. These were split into two parts:

- **General sustainability-related disclosure requirements:** Covering requirements for disclosing sustainability-related financial information that enables users to evaluate a company's risks and opportunities. This builds on current SASB Standards and embeds SASB's industry-based approach to standards development. Use of SASB Standards, therefore, will be good preparation for implementation of the standards when they are available for use. SASB Standards enable robust implementation of the Integrated Reporting Framework, providing the comparability sought by investors.
- **Climate-related disclosure requirements:** Covering requirements for disclosing exposure to climate-related risks and opportunities that may affect a company's current financial position. This builds on the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD) and is consistent with the TCFD recommendations. The ISSB published a comparison document that shows how the proposals are consistent with the TCFD's four overarching themes (Governance, Strategy, Risk Management, Metrics & Targets) and 11 recommended disclosures.

	Standards to be issued in combination with financial statements
	Focus on full transparency in all disclosures
	Reliance on self-disclosure but with specific definitions around materiality to ensure consistency
	Climate related disclosure to require reporting of Scope 1, 2 and 3 emissions
	Climate related disclosure to include Climate related scenario analysis

Table 1: Summary of ISSB Recommendations

The objective of these standards is to define a reporting framework that is simple and easy to apply, and appropriate across sectors.

The consultation period ended in July. There was a good level of engagement from the industry. However, as often is the case with consultations, there were opposing views from different stakeholders, with some bodies feeding back that the standards do not go far enough, whilst others pushing back that they are too strong.

ISSB are currently in the process of reviewing the feedback and discussing revisions. ISSB is aiming to publish the finalised standards in early 2023. We do not yet know the exact content of what will be included. However, we have summarised some of the key points below, based on the proposed standards and the updates provided around the consultation feedback.

Some of the feedback focused on the wording and definitions included in the standards. A common theme was that the proposed standards did not go far enough to define materiality or mandate the circumstance in which information must be disclosed. Other feedback was around the specifics of reporting – such as discussion around inclusion/exclusion of scope 3 emissions.

In general, our impression is that ISSB has used the consultation period to refine the working around the reporting standards and tighten definitions. It does seem less open to changing its position on the information that should be disclosed. This provides comfort that the overall objectives of ISSB are not being diluted as part of the industry consultation.

And at COP27, a key announcement was made on 8 November 2022; CDP, the world's biggest disclosure platform, is to incorporate the ISSB standard into its global environmental disclosure platform. This is a major step towards delivering a comprehensive global baseline for capital markets through the adoption of ISSB standards. It will be incorporated into CDP's existing questionnaires which are issued to companies annually on behalf of 680 financial institutions with over $130 trillion in assets.

Our view

There has been a clear call from industry that reporting needs to be standardised and regulated. If this is not realised, there is a real risk of increased scepticism around greenwashing. More than that however, the value of the investment many companies are making into sustainability risks are not being valued appropriately.

In our view, the ISSB standards provide a useful working prototype. As with accounting and taxation reporting, we expect that these standards will be refined based on feedback after they are applied in practice - albeit on a much quicker timeframe than the development of accounting and taxation regulations.

It is a necessary, but ambitious, objective to define a 'one size fits all' set of sustainability reporting standards. We expect that as these standards are applied, different industries will identify their own gaps and challenges. We believe that there is a vital role for industry regulators and bodies to take these ISSB standards as an overall framework and tailor them to meet the needs of specific industries.

Overleaf, we set out some of the specific reporting standards we would expect to consider when looking at the transport infrastructure industry.

Focusing on the transport infrastructure industry, we would expect the following reporting as a minimum:

	Existing levels of gross global Scope 1-3 emissions
	Net fuel consumption by transport mode (including supply chain) and by percent natural gas and percent renewables
	Percentage of supply chain carriers with BASIC percentiles above the FMCSA intervention threshold
	Long-term and short-term strategy to manage the emissions, emissions reduction targets, and an analysis of performance against those targets

Table 2: Summary of Proposed Transport Infrastructure Reporting Requirements

There is an opportunity for reporting standards to not just ensure compliance, but to encourage real world change. Global, comparable standards would help hold companies to account and allow investors to make informed decisions. Such standards which reported on a regular and consistent basis will result in clear action from investors; asset owners and operators; and regulators and grantors, all of which should give stakeholders clarity on how specific sustainability objectives are being achieved.

We do not expect reporting standards alone to get sustainable investment to where it needs to be to meet international targets. However, we believe that the absence of reporting standards is currently stalling progress. Therefore, by pairing the launch of the ISSB standards with clear targets and incentives, we can expect sustainability to become even more of a consideration in investment decisions.

Complex questions.
Powerful answers.