

**‘E’-Harmony**  
The Quest to Standardize Environmental  
and Sustainable Reporting

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# 'E'-Harmony

## The Quest to Standardize Environmental and Sustainable Reporting

### Critical Steps for Sustainable Investing

Would it surprise you to learn that the CEOs of some of the world's largest energy companies have *quantitative* relationships directly tying their compensation to climate related targets?<sup>1</sup>

Or that by 2027, the resale clothing industry is poised to overtake fast fashion?<sup>2</sup>

Or that in September 2020, a working group of the Commodity Futures Trading Commission (CFTC), hardly a bastion of tree hugging environmentalists, issued a 165 page report stating: "climate change poses a major risk to the stability of the U.S. financial system and to its ability to sustain the American economy."<sup>3</sup>

While some wondered if the Covid-19 pandemic would derail the exponential growth in sustainable investing over the last few years, the opposite seems to be true. Assets growth into ESG products in 2020 hasn't just endured – it continues to accelerate.

One driver of this is the growing acknowledgement that there are material sustainability factors that directly impact a company's financial and operating performance – but that aren't currently captured in traditional financial statements. As such, one considerable challenge remains to truly embedding sustainable considerations in the investment process.

**You cannot manage what you do not measure.** Until there are recognized and accepted standards in reporting around sustainable issues – as financial metrics over time were standardized – it will remain challenging for investors to fully incorporate these concerns into their research, risk and investment processes. But for the first time – harmonization of standards seems closer and more realistic than it ever has been.

There are dozens of different global and regional standards for ESG issues – most specifically around climate adjacent topics. But they lack the true standardization that allows them to be fully incorporated into investment theses.

*'E'-Harmony* examines the what, how, how often and why of sustainability reporting, and what may lie ahead for companies and asset managers alike.

For the first time, the chorus of investors seeking and companies' self-reported willingness to issue these metrics on a consistent basis are converging. It is an exciting time for those focused on sustainability related issues, and their interplay with the capital markets. We hope *'E'-Harmony* helps to unpack some of these challenges, some of the opportunities, and the road ahead for a harmonized set of clear, robust and accurate reporting standards.

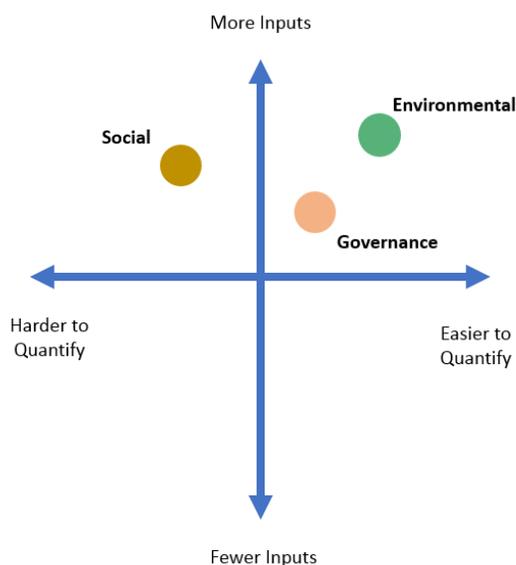
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## ON A ROLL: CONSIDERABLE TAILWINDS FOR THE EVENTUAL HARMONIZATION OF STANDARDS

In an earlier piece, we noted that each of the pillars of ESG investing has numerous – if not dozens – of subdimensions and potential inputs.<sup>4</sup> There is considerable divergence, however, in the quantifiability of these inputs and factors.

But environmental and climate adjacent concerns have risen to the fore as a focus for investors and climate conscious companies.



Source: Jefferies

We will put aside governance standards now – as those are somewhat more mature and broadly accepted than social or environmental issues.

There are a large and growing body of regional and global standards meant to address climate and environmental concerns. They may vary by sector, by region or by company size.

What is perhaps the largest indicator of an eventual harmonization of reporting standards were have been the growing number of headlines around collaboration across a number of these frameworks.

In mid July 2020 – SASB (Sustainability Accounting Standards Board) and GRI (the Amsterdam based Global Reporting Initiative) announced a “collaborative workplan.”

This, to put it plainly, is a big deal.

As more and more investors acknowledge the financial materiality of new factors and inputs to business performance, efforts like this are critical, and they are increasingly seen as a new century’s version of the development of broadly accepted and standardized financial metrics as happened following the Great Depression.

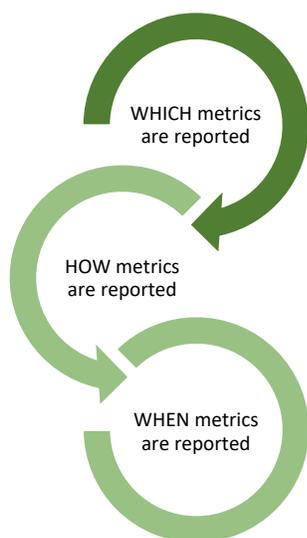
SASB and GRI are two of the largest, most globally accepted, and most referred to frameworks regarding ESG disclosures. Together with the Task Force for Climate Related Disclosures (TCFD), they are among the most highly referenced frameworks. Coming together around transparency and reporting, the two groups indicated a willingness to work together to “collaborate to demonstrate how some companies have used both sets of standards together and the lessons that can be shared.”<sup>5</sup>

We explore each in the table below, but SASB is known for its focus on sustainability adjacent issues’ impact on firms’ financial performance (i.e. – their balance sheets), their operating capacity and the risks posed thereto, and various capital allocation considerations.

There is, simply, a growing consensus that there are other drivers and factors of financially material information and metrics that are not currently captured in regularly reported financial statements and balance sheets. Materiality shifts over time, and it is increasingly clear other factors are impacting companies’ success or failure.

## MAPPING THE LANDSCAPE: LOOKING AT VARIOUS FRAMEWORKS FOR SUSTAINABILITY REPORTING

In the past thirty years, a growing body of organizations and initiatives have put forth frameworks to assist companies in thinking through how to report non-financial factors that may be material to their business footprint.



Most broadly, the highest level questions give rise to related and critical questions:

- **WHICH** metrics are reported
  - What forms of climate adjacent standards should be publicly available?
  - Carbon emissions? Waste metrics? Water consumption? All of the above?
- **HOW** metrics are reported
  - As part of quarterly earnings?
  - As a section of the balance sheet?
  - Should there be uniformity across units of measure and time?
- **WHEN** metrics are reported
  - Quarterly?
  - Annually?
  - Episodically?

In September of 2020, a number of the major reporting frameworks issued a statement of intent to collaborate around identifying, outlining and enhancing various material metrics associated with sustainability and enterprise performance. SASB, the GRI, the Carbon Disclosure Project (CDP), the Climate Disclosure Standards Board (CDSB), the International Integrated Reporting Council (IIRC) and the Task Force on Climate Related Disclosures (TCFD) are getting serious about harmonization.

At the heart of this effort is the **concept of materiality** and the question: **do issues involved with sustainability rise to a level of materiality that could enhance or challenge an organization's financial condition or ability to operate currently or on a go forward basis.**

It is clear that harmonization will not happen overnight. Instead, we expect incremental movements – either on a subject or sector basis – that will lead to more transparent, regular and standardized reporting regimes around issues of sustainability. With global framework organizations increasingly approaching each other to harmonize their frameworks and metrics, often from slightly different perspectives, it is becoming more likely that certain issues around sustainability will either enter the recognized and accepted financial reporting mechanisms today, or emerge as their own complementary body of information and figures.

## SNAPSHOT OF MAJOR REPORTING REGIMES

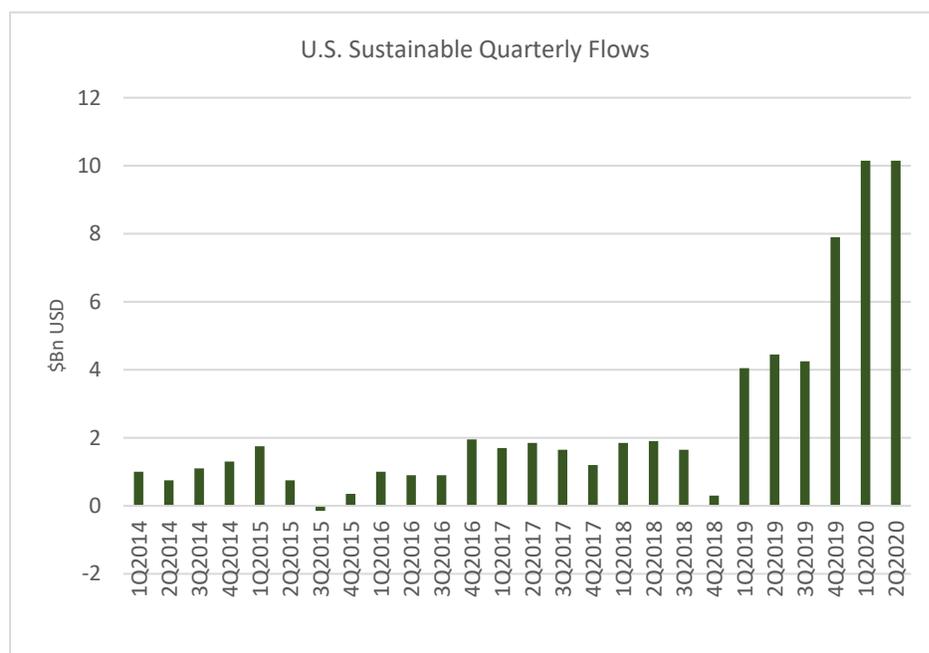
FRAMEWORK	THE LONG & SHORT OF IT	OTHER NOTABLES
<b>SASB</b> <i>Sustainability Accounting Standards Board</i>	<ul style="list-style-type: none"> <li>SASB’s objective is to establish and maintain industry-specific standards that assist companies in <b>disclosing financially material, decision-useful sustainability</b> information to investors<sup>6</sup></li> <li>This near decade old organization is <b>among the most cited</b> and referenced and works to be a complement to FASB (Financial Accounting Standards Board)</li> <li>More than <b>330 companies</b> report SASB metrics and over <b>800 reference</b> them<sup>7</sup></li> </ul>	<ul style="list-style-type: none"> <li>In September 2020, SASB, together with the CDP, CDSB, GRI, TCFD and the IIRC announced their intent to collaborate on an attempt to “outline an <b>approach to standard-setting that results in a globally agreed set of sustainability topics and related disclosure requirements</b> that can serve distinct materiality concepts”<sup>8</sup></li> <li>SASB was one of two frameworks referenced by major asset owners/managers (alongside TCFD) like <b>BlackRock and Canada Pension Plan Investment Board</b> as a valuable framework to assist in sustainability related reporting</li> </ul>
<b>GRI</b> <i>Global Reporting Initiative</i>	<ul style="list-style-type: none"> <li>The Global Reporting Initiative is used by more than 10,000 companies globally in some capacity<sup>9</sup></li> <li>It is <b>among the most cited</b> and referenced as the GRI works to help companies themselves disclose and report on sustainability issues</li> <li>Initially a framework for helping companies and other organizations discuss their impact on broader issues like climate, corruption or human rights, GRI launched a set of <b>standards/metrics</b> in 2016</li> <li>GRI has a different interpretation of materiality from SASB, and they are often referred to as complementary.</li> </ul>	<ul style="list-style-type: none"> <li>Where SASB approaches reporting and transparency from the lens of financial materiality, the GRI is focused on transparency around sustainability to reflect the company’s <b>impact</b> on issues like climate, corruption or human rights</li> <li>Like other frameworks, the GRI recently <b>incorporated a sector focus overlay</b> to its work, allowing for and highlighting variability within and across sectors and subsectors</li> <li>In the summer of 2020, the GRI and SASB announced a <b>“collaborative workplan”</b> to communicate and share case studies as to how companies may report leveraging both frameworks. This workplan did not initially call for a single set of new standards between them, but leaves the door open for heightened engagement and collaboration in the future</li> </ul>
<b>TCFD</b> <i>Task Force for Climate Related Disclosures</i>	<ul style="list-style-type: none"> <li>With the grounding principle that climate change is a financial risk, the TCFD is among the more <b>focused frameworks</b> – it is focused on the business and enterprise risks (or opportunities) posed by climate change</li> <li>Surveys four high level topics: <b>revenues, assets &amp; liabilities, expenditures and capital &amp; financing</b></li> <li>TCFD was established by the <b>Financial Stability Board</b>; like SASB, it is focused on the financial materiality and impact of sustainability issues – namely, climate and has <b>more than 1,000 companies</b> voluntarily adopting their reporting standards</li> <li>Offers <b>four broad topics for the regular release of climate metrics relating to: governance, strategy, risk management, and metrics &amp; targets</b></li> </ul>	<ul style="list-style-type: none"> <li>The Financial Conduct Authority (FCA), in proposing a new listing rule in September 2020 around enhanced reporting, indicated that it <b>anticipates that all listed issuers will be disclosing in accordance with the TCFD recommendations by 2022</b></li> <li>The TCFD often appears in top asset managers or institutional investors’ focus on understanding specifically climate and carbon reporting metrics, alongside SASB or the GRI</li> <li>As noted above, CPPIB and BlackRock look to the TCFD in aligning their portfolio with climate objectives – expecting companies they invest in to align their reporting around sustainability with TCFD and SASB guidelines.</li> </ul>
<b>SDGs</b> <i>Sustainable Development Goals</i>	<ul style="list-style-type: none"> <li>Led by the UN, they are a global framework of <b>17 objectives</b> to build a more peaceful and prosperous world</li> <li>They replaced the UN’s Millennium Development Goals of the 2000s</li> <li>Companies regularly report on the alignment of their business approaches with multiple (or in some cases, all) of the updated SDGs</li> </ul>	<ul style="list-style-type: none"> <li>The SDGs are among the broadest and diverse of reporting frameworks, hitting a variety of topics</li> <li>As such, companies report their alignment with or objective to align with in a variety of different ways</li> </ul>
<b>UN PRI</b> <i>Principles for Responsible Investment</i>	<ul style="list-style-type: none"> <li>A <b>six principle framework</b> for incorporating ESG into investment processes</li> <li>More a signatory/attestation model that investment firms take ESG principles into consideration for investment &amp; decision making, consideration for asset ownership and inquiries around transparency and reporting</li> </ul>	<ul style="list-style-type: none"> <li>Focused on the future and <b>way forward for responsible investment</b></li> <li>The UN PRI reports nearly \$30 trillion USD in “responsible investment strategies used in actively managed assets for equities and ~\$30 trillion USD in the same for fixed income</li> </ul>

## WHAT DOES ALL THIS MEAN?



Asset owners, asset managers, regulators, and companies across sectors are all asking themselves these questions.

What is clear is that sustainability has become a permanent feature of the global investing landscape. Even as Covid-19 roiled markets and prompted a global rethink of some of our most basic investment assumptions, the momentum that had been building behind ESG and sustainable investing only accelerated.



Source: Morningstar

The assets are flowing – but the taxonomy around the products themselves, their investment strategies, their underlying investments and risk process, with regards to sustainability, remain somewhat murky.

The importance of this harmonization of standards, terms and metrics brings the investment industry far closer to its now-taken-for-granted ability to evaluate a company based on broadly accepted financial metrics.

## SUSTAINABLE FACTORS ARE MATERIAL FINANCIAL METRICS

An appropriate parallel may be the development of traditional accounting standards.

### DEVELOPMENT OF CURRENTLY ACCEPTED FINANCIAL METRICS

#### Development of financial accounting theory:

- The concept there are multiple factors that converge to shape a company's operating and financial success

#### Agreement on the selection and standardization of these metrics in formal financial statements:

- The S1s, 10Ks, and 10Qs we have come to know and love



#### Development of financial accounting METRICS:

- Vetting the who, what, when, where, why and how that determines a company's operating and financial success...EBITDA? Depreciation? Assets?

### DEVELOPMENT OF POTENTIALLY ACCEPTED SUSTAINABILITY METRICS

#### Development of sustainable materiality theory:

- The concept there are multiple factors **beyond broadly accepted financial ones** that also shape a company's operating and financial success

#### Agreement on the selection and standardization of these metrics in formal statements:

- To be determined!  
- But may end up as part of S1s, 10Ks and 10Qs or some other required formal reporting



#### Development of sustainability METRICS:

- Vetting the who, what, when, where, why and how that determines a company's operating and financial success...Carbon emissions? Water usage? Board and talent development?

## THE KNOWN KNOWNS AND THE KNOWN UNKNOWNNS

So what do we know?

We know:

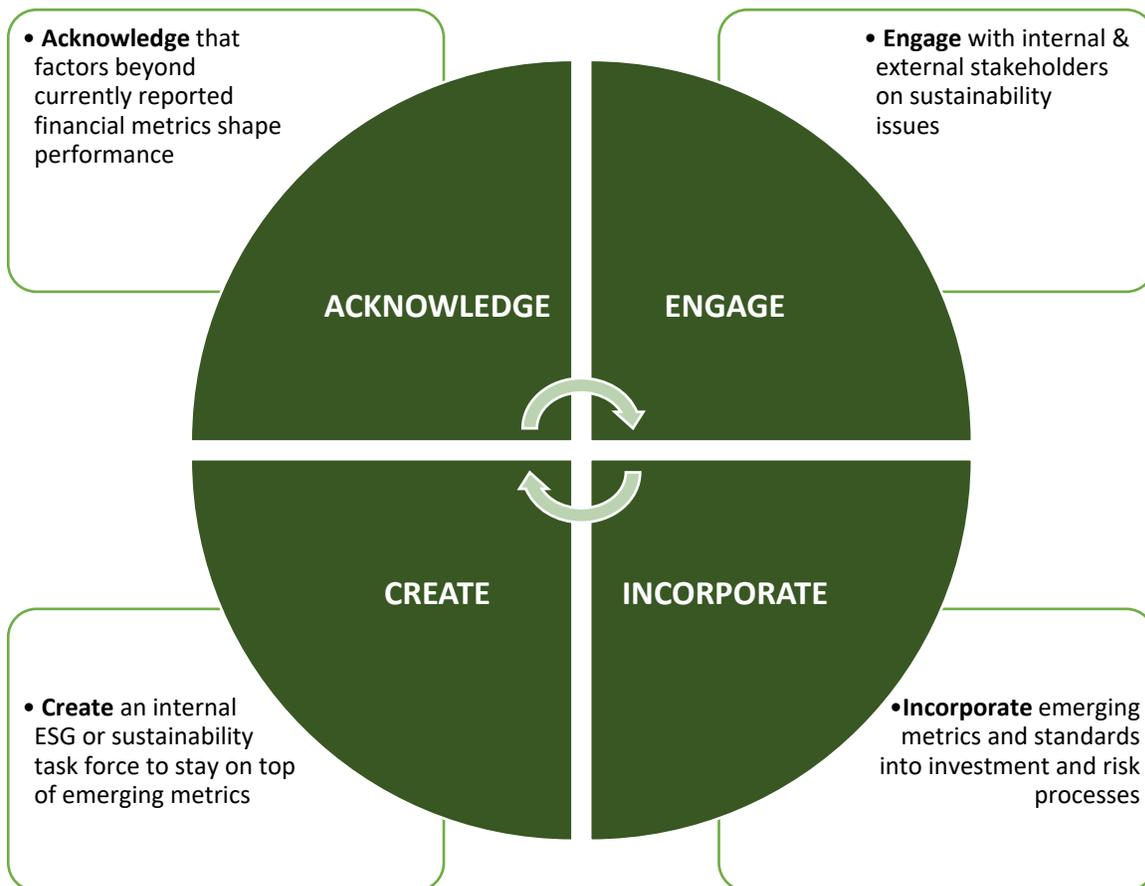
- **The interest in sustainable investing is here to stay...and is growing**
- **But questions remain about the standards by which companies will be judged around materiality and sustainability**
- **To that end, global organizations with different sustainability standards are starting to converge and collaborate, much in the manner exchanges, regulators and professional groups began to do for financial metrics following the Great Depression**

We *don't* yet know:

- **What those standards will be**
- **What is the materiality of these standards across regions and across sectors**
- **How quickly will these standards emerge**

In the interim....

### WHAT CAN MY FIRM DO?



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## ENDNOTES

<sup>1</sup> Total Energy: Integrating Climate Into Our Strategy. 2019. Available at:

[https://www.total.com/sites/g/files/nytnzq111/files/atoms/files/total\\_rapport\\_climat\\_2019\\_en.pdf](https://www.total.com/sites/g/files/nytnzq111/files/atoms/files/total_rapport_climat_2019_en.pdf)

<sup>2</sup> ThredUp 2020 Resale Report. Available at: <https://www.thredup.com/resale/>

<sup>3</sup> "Managing Climate Risk in the U.S. Financial System." Report of the Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission. Available at: <https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf>

<sup>4</sup> MSCI, S&P Global, Jefferies

<sup>5</sup> <https://www.sasb.org/blog/gri-and-sasb-announce-collaboration-sustainability-reporting/>

<sup>6</sup> SASB.org

<sup>7</sup> SASB Reporters refers to companies who have disclosed SASB metrics in public company communications. SASB References refers to company mentions of SASB, for metrics reporting or other purposes, in public company communications. [www.sasb.org](http://www.sasb.org)

<sup>7</sup> Statement of Intent to Work Together. Available at: <https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work-Together-Towards-Comprehensive-Corporate-Reporting.pdf>

<sup>7</sup> GRI.org

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