Holding businesses accountable for sustainability

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Foreword

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The path to clearer sustainability disclosures

Robust reporting standards and frameworks are the vital foundation tools for organisations in the rapidly accelerating global drive to reach net zero emissions.

Reporting frameworks help companies to prioritise, call out and constantly improve on their key areas of sustainability focus – and their significance cannot be overlooked in this era of heightened ESG action as commitments grow exponentially and targets loom.

With numerous frameworks and standards to choose from, the task of evaluating how each framework differs and which best represents an organisation's ESG impact remains challenging.

Investors have long been highlighting the need for consistency in reporting as the urgency for climate action has picked up pace and more nations are moving from voluntary to mandatory approaches.

Across the world, eyes are on the latest efforts towards a more unified approach with the long-awaited announcement of the establishment of the International Sustainability Standards Board (ISSB) at COP 26. This brings together the International Integrated Reporting Council, the Sustainability Accounting Standards Board (briefly known as the Value Reporting Foundation), with the Carbon Disclosure Standards Board under the umbrella of the International Financial Reporting Standards Foundation. The ISSB has already kicked off its work with prototypes for sustainability and climate disclosures.

In this fourth report on the rapid evolution of sustainable finance for Westpac Institutional Bank by Bloomberg Media Studios, we explore the options and the shakedown of reporting standards and frameworks, and why the Task Force for Climate-Related Financial Disclosures, or TCFD, is emerging as the global 'best-practice' way forward for climate reporting. We also look at the uptake of TCFD recommendations by Australia's top companies, a move encouraged by the Australian Sustainable Finance Initiative with the critical need to keep local entities internationally competitive and on a clear path to net zero.

For their thought-provoking insights in this report, our special thanks to Fiona Wild, Vice President, Sustainability and Climate Change at BHP, and member of the Task Force on Climate-Related Financial Disclosures and Fiona Reynolds, CEO, Principles for Responsible Investment.

Holding businesses accountable for sustainability

Companies are under increasing pressure to decarbonise and disclose sustainability-related risks and opportunities amid the global drive to realise net-zero emissions. While several reporting standards and frameworks promise to make that easier, setting commitments is challenging for those new to the world of corporate sustainability.

Central to that challenge is the concept of materiality – the often-complex process of working out what information is important enough to influence an organisation's stakeholders. For sustainability reporting that typically means the economic, environmental, and social impacts of its activities.

Reporting frameworks help companies navigate that challenge. There are eight core environmental, social, and governance (ESG) reporting standards and frameworks. In each case, alignment requires determining a company's environmental and social impact,

COMMON SUSTAINABILITY REPORTING STANDARDS & FRAMEWORKS

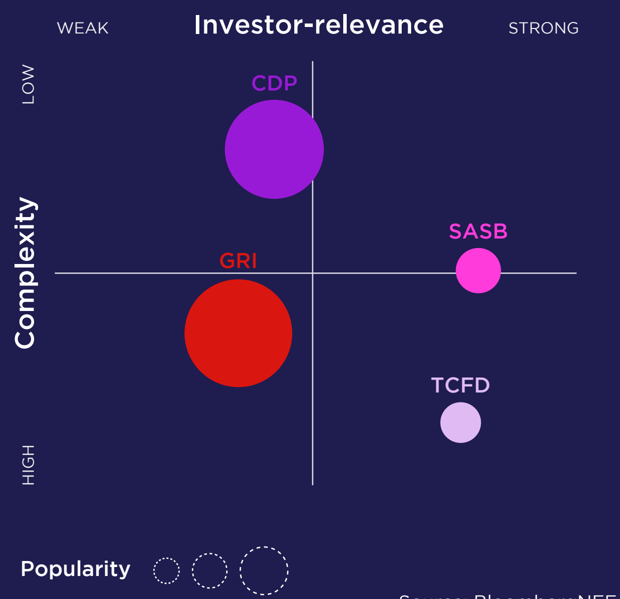
Standard/ Framework	Topic focus	Founding year	Disclosure format
GRI	Environmental and social	1997	Company filings
GREENHOUSE GAS PROTOCOL	Carbon	1997	Company filings
CDP	Carbon, water, forests	2000	CDP questionnaire
SASB	Environmental, social and governance	2011	Company filings
TCFD TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES	Climate change	2015	Company filings
PRI Principles for Responsible Investment	Financial, environmental and social	2005	Company filings
CDSB Climate Disclosure Standards Board	Climate change and natural capital	2007	Company filings
INTEGRATED REPORTING <IR>	Financial, environmental and social	2010	Redesigned integrated report
ISSB	Environmental, social and governance	2021	Company filings

supporting that with data, and building a robust reporting and communications strategy. Add to that the task of securing buy-in from internal and external stakeholders and it becomes clear why first-timers are often overwhelmed.

Choosing the most appropriate standard or framework is another challenge. While there is often overlap across focus areas, they vary in terms of complexity, investor relevance and disclosure formats. Less complex standards and frameworks, for instance, are easier to report against, but do little to signal the impacts, risks, and opportunities around sustainability to investors. By contrast, their more complex counterparts are favoured among investors but require more effort for alignment.

"You get a lot of different frameworks because they're coming from slightly different angles and perhaps with slightly different intent," says Fiona Wild, Vice President, Sustainability and Climate Change at BHP, and member of the Task Force on Climate-Related Financial Disclosures (TCFD).

COMPARING SUSTAINABILITY REPORTING STANDARDS & FRAMEWORKS



Source: BloombergNEF

"The benefit is that it gives the market an opportunity to figure out what works best. If there were 100 different metrics and opportunities to report against, people might start to coalesce around the 20 that work best and are most relevant and useful. The downside is knowing which ones to report against and managing the volume of material that is required to disclose."

The International Financial Reporting Standards (IFRS) Foundation promises to simplify and standardise reporting. As world leaders convened in Glasgow for COP26 in November 2021, it launched the long-awaited International Sustainability Standards Board (ISSB). The goal: create a comprehensive global baseline of high-quality sustainability disclosure standards to meet investors' information needs. ISSB creates the necessary institutional arrangements and lays the technical groundwork for a global sustainability disclosure standard-setter for financial markets.

Beyond setting a global standard, the ISSB could help navigate materiality by embracing a dynamic approach. Popularised by the World Economic Forum (WEF), the concept of dynamic materiality recognises that what is financially immaterial to a company or industry today can become material tomorrow. Identifying and adjusting for such issues will be a capability that businesses and investors cannot do without.

While getting started is not easy, committing to a reporting framework is both worthwhile and necessary. Nearly half of investors in a recent global survey said they frequently invest in sustainable funds rather than those that do not consider sustainability factors. Likewise, 87 per cent of consumers in another survey said that companies should integrate environmental concerns into their products, services and operations to a greater extent than they have in the past. As the world strives towards a cleaner, greener, more equitable future, companies must put sustainability at the core of their operations.

"Investors increasingly recognise the threat posed by climate change to the global economy, and therefore to their ability to meet the needs of their beneficiaries over the decades to come," says Fiona Reynolds, CEO, Principles for Responsible Investment (PRI).

"Many now recognise the enormous opportunity for economic growth and investment returns presented by the transition to net-zero emissions. For investors, reporting disclosures provide transparent and accurate data that allows stakeholders to learn and improve to meet their net zero commitments. By committing to climate-related financial disclosures, investors demonstrate sector leadership and a commitment to a sustainable future."

Standards and frameworks at a glance

Among the different standards and frameworks that companies can align with, four are arguably the most popular: The Global Reporting Initiative (GRI), the Carbon Disclosure Project (CDP), the Sustainability Accounting Standards Board (SASB), and the TCFD.

Launched in 1997, the GRI established the first set of global standards to help companies report on ESG-related impacts in their filings. Today, nearly three quarters of the world's 250 largest companies use GRI. It is especially useful in helping to determine which ESG indicators and targets are appropriate and how best to measure progress against them. However, given fairly flexible guidelines, companies can be selective in what they report, potentially overemphasising their sustainability alignment.

The CDP, launched in 2000, invites companies to disclose historical performance data focused on climate, water, and forests through a questionnaire. In 2020, more than 9,600 companies around the world disclosed through CDP–up 14 per cent from the previous year and 70 per cent from when the Paris Agreement was signed in 2015. With easy alignment and a simple structure, it enables investors to quickly compare companies across markets and industries. Sometimes, however, inherent in simplicity is a lack of flexibility.

Launched in 2011, the SASB helps companies to report the ESG data that is most material to investors. In 2020, there were 1,140 unique mentions of SASB by reporting companies, up from just 79 five years earlier. Consistency in data disclosure between companies in the same industry makes the SASB framework particularly useful for investors who want to understand which ESG metrics are most relevant. One challenge is the lack of thresholds around what constitutes a good performance.

TCFD is among the youngest and arguably the most powerful of the frameworks highlighted here. Launched in 2015, it makes recommendations on how companies should disclose their climate-related opportunities and risks. It focuses on assessing the resilience of a company's business model in the face of climate change. Today, over 2,600 companies around the

COMPARING SUSTAINABILITY REPORTING STANDARDS & FRAMEWORKS

CDP	GRI	SASB	TCFD
STRENGTHS	**STRENGTHS**	**STRENGTHS**	**STRENGTHS**
Aligned with setting up a carbon inventory	Enables benchmarking against self and others	Helps companies identify most relevant, financially-material data to disclose	Uses scenario analysis to spot material future climate risks and opportunites
Structured survey data is popular with survey consumers	Helps with selection of indicators and targets	Popular with investors	Popular with investors
WEAKNESSES	**WEAKNESSES**	**WEAKNESSES**	**WEAKNESSES**
Minimal impact on direct decarbonisation	Less focus on indirect impacts in the supply chain	Limits disclosures to a five-year time horizon	Relatively lengthy guidance, complex implementation
Narrow scope (carbon, forests, water)	Guidance often cherry-picked by companies	Little indication of relative performance	Limited guidance on scenario analyis

Source: BloombergNEF

world support the TCFD. It is particularly popular among investors for providing insights into how climate change may impact their portfolios. However, TCFD recommendations are sometimes difficult to follow, leading to a mismatch between those who support and those who implement them.

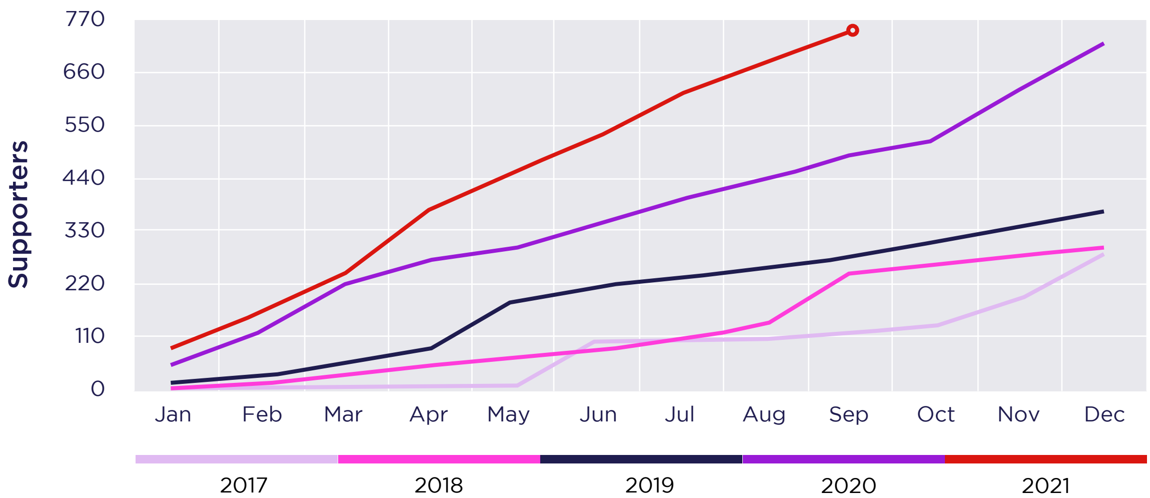
"TCFD is valuable because it's not prescriptive," Wild says. "It doesn't demand that you disclose certain types of information in certain locations in certain timeframes. It takes quite a principled approach. In a sense, it asks companies to ask themselves questions and then disclose how they might think about the answers. So it's less about saying fill this box in, fill this number. It's more about here's some questions your board should be asking, here are some questions your management should be thinking about, tell us how you think about that. And it gives companies room to describe the process, as well as the content."

While the TCFD is increasingly popular, the newly launched ISSB offers a fifth option that could be a gamechanger for sustainability reporting. The ISSB will build on the work of existing investor-focused reporting initiatives to become the global standard-setter for sustainability disclosures for the financial markets. The ISSB's standards will enable companies to provide comprehensive sustainability information for the global financial markets. The standards will be developed to facilitate compatibility with requirements that are jurisdiction specific or aimed at a wider group of stakeholders.

The ISSB's November launch included two prototype documents: one which focuses on climate-related disclosures that build on the TCFD's recommendations and includes industry-specific disclosures, and a second that sets out general sustainability disclosures. These prototypes are the result of six months of joint work by representatives of the Climate Disclosure Standards Board (CDSB), the IASB, the TCFD, the Value Reporting Foundation (VRF) and (WEF), supported by the International Organization of Securities Commissions (IOSCO) and its Technical Expert Group of securities regulators.

Currently, the prototypes are for informational purposes only, providing the market with a sense of direction. The ISSB will consider feedback and recommendations to determine next steps, including the issuance of potential exposure drafts for Standards informed by the Technical Readiness Working Group's work, subject to the independent due process of the ISSB. It could be several months before the impact of the ISSB's launch feeds through to the daily reality of corporate reporting teams.

NUMBER OF NEW TCFD SUPPORTERS BY YEAR



Source: BloombergNEF

Cementing the sustainability mandate

Sustainability reporting standards and frameworks are voluntary in most parts of the world. That is starting to change. In September 2020, New Zealand became the first country to require the financial sector to report on climate risks under the TCFD framework. And nine other national governments including the U.K. and Switzerland are committed to making risk disclosure along TCFD guidelines mandatory.

Recent surveys underscore the need for government mandates. One survey on ESG practices at companies across the U.S., U.K., France, and Germany showed that while 81 per cent had formal ESG programs in place, only half of the respondents believe their company performs well against environmental metrics. Less than two-fifths said their company performs well against metrics on governance and social issues. Meanwhile, an analysis of annual and audit reports showed that 90 per cent of the U.K.'s largest listed companies make no reference to climate-related factors in their financial accounts.

"Around the world, PRI signatories continually report that a lack of consistent, comparable and standardised ESG information from issuers is their greatest barrier to incorporating ESG data in their investment practices," Reynolds says.

"Clearly, investors need a step-change in issuer disclosure to help navigate their way through a future in which the world's major economies are actively transitioning to net-zero. Addressing these information barriers will be essential to a market-based response to climate change."

Against this backdrop, several other countries could make TCFD reporting mandatory this year. The U.S., for instance, is widely expected to follow suit given President Joe Biden's focus on climate-related initiatives. Countries that have set net-zero targets, such as Japan and South Korea, are also likely to push through such legislation.

A common question is why TCFD and not one of the other standards or frameworks? The 11 disclosure recommendations that the TCFD outlined in its final report in 2017 help companies to produce information about their approach to resilience, purpose, society and the environment that is useful for investors. The results are more relevant for investors than those that the other frameworks yield. Thus, TCFD is now widely considered the international best practice for climate-related financial reporting.

"In step with the growing threat of climate change is increasing demand from the financial community for information to help them understand and incorporate climate and broader ESG factors in their investment practices," Reynolds says. "The need for decision-useful ESG information is increasing at an unprecedented rate. The TCFD is the best available framework for investors to demonstrate and inform shareholders of how they are addressing climate-related risk."

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CEO, Principles for Responsible Investment (PRI)

Climate mandates down under

As the world strives to overcome the challenges of global warming, Australian companies are driving change. Banks, insurers, and fund managers are pledging to no longer finance new coal-fired power stations and calling for collective net-zero emissions targets. Utilities and resource players are making net-zero commitments. And industry-led groups are providing guidance and recommendations.

To put companies on the right path for reporting, the Australian Sustainable Finance Initiative (ASFI) recommended that financial institutions with annual consolidated revenue of more than $100 million report according to the TCFD recommendations by 2023. Likewise, it suggested that all Australian Securities Exchange (ASX) listed companies do the same. While not mandated, this could facilitate Australia's path towards a net-zero emissions future.

"If a company is asking the questions that TCFD is posing and responding to those questions in a thoughtful way, and it is allowing a more engaged conversation with investors and others, then it can only be a help in terms of getting us closer to net zero, because it is bringing to light the climate risks and opportunities," Wild says. "It is asking questions about strategy. It is asking questions about resilience. And, with the insight that that gives, it drives you towards action."

Currently, 58 per cent of ASX100 companies are using TCFD recommendations for financial reporting, up from just 16 per cent three years ago. And 93 Australian companies in total support the TCFD, representing just over 5 per cent of all supporters. With a record number of Australian companies having announced new sustainability commitments in 2021, we could see greater alignment going forward.

The ISSB could further catalyse corporate action and alignment. It marks a huge step forward in the decades-long quest to standardise corporate sustainability disclosures. The emergence of a global baseline of dynamic, high-quality sustainability disclosures standards leaves businesses and investors with few excuses not to align amid the drive to preserve our planet for future generations.

"Failure to align Australian reporting expectations with other major jurisdictions implementing mandatory regimes would leave Australian companies and investors subject to multiple regulatory frameworks further increasing regulatory complexity and confusion," Reynolds adds.

"The PRI has recommended progressively extending coverage across all major financial institutions and companies over time, starting with the ASX300 and large unlisted entities as a priority. Establishing a mandatory regime would provide much needed clarity for companies and financial organisations."