ADBI Institute: Workshop on Transition Finance in Asia
Climate-related disclosure effective for transition finance in Asia
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Context

My remarks are largely from an investor perspective given our members collectively represent around $77 trillion in global assets. Our mission is to develop high standards of corporate governance and investor stewardship worldwide to preserve and enhance long-term value – ultimately contributing to sustainable economies, societies, and the environment.

We are living in extraordinary times as we emerge from the Covid pandemic and now face a global market downturn, fuelled by rising inflation and weakening economic growth. Russia's war against Ukraine, alongside degenerating US – China relations, and resultant food and energy shortages is distracting political attention away from the urgency of climate change – despite this being a systemic threat to humanity on a magnitude of importance like no other.

ICGN welcomes assertive action by regulators and standard-setters on climate-related reporting: last month we responded to the US SEC and will submit letters to ISSB and EFRAG shortly. This follows our Statement to COP 26 last year and our comments to the Canadian Securities Regulators in March.

Sustainability reporting is no longer a 'nice' to have – it really is 'must' have. As well as reducing the reporting burden on companies, harmonised standards will equip investors with rigorous, consistent, comparable, and verifiable sustainability information, backed (we hope) by regulation and enforcement. This will enable the proper assessment and pricing of climate-related risk, opportunity, and resilience in investee companies. More broadly it provides a tool for assessing progress towards achieving corporate transition plans and carbon neutral investment portfolios as we collectively advance towards a net-zero global economy by 2050.

Regulatory developments

You may be aware that the European Corporate Sustainability Reporting Directive was published last week which includes reference to the ICGN Global Governance Principles which are used by many ICGN Members in their voting policies and company engagements. ICGN is cited - alongside OECD - as an authoritative global framework of governance information of most relevance to users. GRI and TCFD are also recognised as reporting frameworks. EFRAG standards will link directly to this regulatory requirement making it mandatory for over 50,000 largest EU companies.

ICGN welcomes Europe's 'double' materiality approach requiring companies to report - not only on sustainability factors impacting the performance of a company - but also the impact of the company itself on society and the environment.

We also welcome the more targeted approach by the ISSB from a 'single' materiality lens which measures sustainability impacts - starting with climate - on the financial position and prospects of the company itself. We understand that ISSB will focus on other broader sustainability factors over time.

Under ISSB's approach, investors are intended as the primary users of corporate reports, which is distinct from the EFRAG position which considers both investors and stakeholders as audience. As public and political scrutiny increases on the role of companies (and investors) - in society, it is in all our interests to harmonise these concepts to facilitate truly global sustainability reporting standards.

I should add that ICGN views the creation of the ISSB as a milestone moment given its positioning under the IFRS Foundation, alongside the IASB, which we hope will facilitate coordination of efforts, complementarity of standards, and connectivity of historic and forward-looking information.

ICGN also applauds national efforts to expedite regulatory requirements aligned with the TCFD which is becoming mandatory in many markets. Together these initiatives present a historic opportunity for a globally harmonised baseline on sustainability reporting and will help minimise regulatory fragmentation.

These standards should be applied to both public and private companies. The pace of adoption should be tailored according to company scale given the greater resource constraints faced by small to medium sized companies, relative to larger pees. This extends to companies operating in the Global South, many reliant upon financial support promised by Richer Nations to implement net-zero plans but not yet fully received.

Climate-related financial accounting, reporting and auditing

The case is already clear for many ICGN Members who recognize climate risks and opportunities as material, and which influence their decision-making. As such many investors are calling for stronger reference to this in corporate financial statements, aligned with the Paris Agreement.

By way of example, Climate Action 100+ has added metrics on accounting and audit to their benchmark for assessing company performance on climate change. You may be aware that 52% of shareholders supported a resolution asking the Board of Exxon at its AGM this year to publish an audited account of how its financial position would be impacted by a 1.5C pathway.

In recognition of this investor demand, two years ago, the IASB published guidance to companies for including climate considerations in financial statements, in line with existing standards. Recent guidance by the IAASB reminds auditors that material climate risks should be considered in the same manner as any other material factor in the audit process.

Accounting regulators have reinforced this message to both companies and auditors that they must, under existing rules, ensure they cover material climate risks. Both the U.K.'s

Financial Reporting Council and the European Securities Markets Authority issued statements last year to warn of their increasing scrutiny on this.

Ultimately, investors expect auditors to ensure that climate related assumptions and judgements are sound, and that the financial statements provide a fair representation of a company's economic health. While it may take some time for auditors to build capacity to provide this assurance, ICGN welcomes enhanced regulatory scrutiny this to expedite greater use existing rules which will improve climate related assurance.

We should also acknowledge debate around the format and timing of climate related reporting. Separate reports which consolidate this information should not replace the need to reflect the financial consequences of climate impacts within the financial statement itself (including in the Notes). The publication of a separate climate report as a standalone document without linkage to the financial statements could infer that climate impacts are not financial or material, which is misleading, so both should be published at the same time.

TCFD aligned disclosure

Many regulatory consultations include questions around key pillars of the TCFD framework so I will comment on governance, strategy, risk, metrics, and targets. It is also worth noting that the EU CSRD mentioned earlier requires sustainability reporting standards to include information around the companies administrative, managerial, and supervisory bodies as well as describing their expertise, incentives, internal controls, and risk management related to sustainability.

Governance

Good governance is the backbone to achieving a company's public commitment to net-zero targets by 2050. Companies should disclose how corporate boards oversee the adaption of business models to net zero carbon emissions through credible and actionable net zero transition plans aligned with the company's purpose and long-term strategy.

A report from Deloitte this year found the need for more education with climate competence among Audit Committee members lacking with many directors feeling out of their depth. Another survey by PWC and The Conference Board found that boards are not spending enough time on climate change issues. This was emphasized by Carbon Tracker which found that board agendas do not feature climate risks sufficiently - many assessing on an annual basis, while others approach this ad-hoc.

Effective board oversight relies on a there being a genuinely diverse group of directors with relevant knowledge, independence, and experience to ensure effective and inclusive decision-making. Boards should seek directors with broad knowledge of climate change and sustainability matters, whilst also relying on outside expert advice when necessary. Interestingly a survey published by the Global Network of Director Institutes found that 69% of respondents of around 2,000 directors envisaged a greater role for outside experts in risk scenario planning and decision-making.

So, we welcome the disclosure requirements as suggested by ISSB to include board expertise, resources and the processes and frequency by which the board / or committees discuss climate related risks. We also recommend that this should be explicitly referred to in the Board Charter or appropriate committee terms of reference, along with the responsibility for sustainability risks and opportunities more broadly.

Strategy

With regards to strategy disclosure, companies should describe the impact of physical and transition risks and opportunities on business models over the short, medium, and long-term. This should be aligned with credible and actionable net-zero transition plans including quantitative metrics and targets. The strategy should be periodically reviewed and progress towards achieving key objectives reported annually.

Scenario planning aids strategic and risk management decisions in a structured, systematic, and analytical way. This analysis is essential for establishing climate strategy, transition plans and for allowing investors to assess business model resilience. Companies already face climate related physical; and transition risks and scenario planning can help them to plan, survive and thrive.

Disclosure should describe the resilience of the business taking account different climate scenarios and include both qualitative and quantitative information. This will help investors understand how each scenario will impact risk, strategy, business model and future cash flows.

Some companies have expressed concern about the reliability and costs of conducting climate scenario planning. Yet for many companies, scenario planning is a well-established tool, and many are already disclosing scenario analysis reports. The extractives sector is an example of how scenario analysis can be conducted and how it benefits strategy, risk management and capital allocation.

Some companies have expressed concern around human resource requirements. TCFD estimates that companies will need between 4 to 20 individuals for a duration of 2 to 6 months, depending on size and complexity. TCFD also provides guidance on scenario planning and free on-line training programs, along with others such as IPCC. Widespread tools and consultancy services are therefore now available to support resource efficiency and reduce costs.

On the investor side it is interesting to note that, according to IPE's 2022 Asset Management Guide, the total number of ESG investment specialists has increased by 40% over the past four years - from 1,553 in 2019 to 2,167 in 2022. This demonstrates that enhanced resource commitments as a prerequisite to achieve our goals is a shared endeavour.

Metrics and targets

ICGN supports disclosure of Scope 1, 2 and 3 greenhouse gas emissions in conformance with the Greenhouse Gas Protocol established in 2011.

We recognise the debate around the reliability of Scope 3 data and methodologies but believe these disclosures are material for at least 68 out of 77 sectors as described by SASB and therefore should be madatory. A comply or explain approach may be appropriate for the remaining 11 industry sectors that the SASB regard as having less material exposure to climate risks. We also think that any company publicly proclaiming a net zero strategy, regardless of sector, should disclose Scope 3.

This is important because Scope 3 emissions represent as much as 90% of all company emissions according to Carbon Trust. Companies are already moving in the direction of Scope 3 disclosure even in the absence of mandatory regulations as shown in data from TCFD. And frankly, net zero commitments cannot be achieved by 2050 in the absence of these disclosures.

We understand there are some concerns about the reliability of Scope 3 emission data and methodologies. Considerable expertise has been developed in measuring Scope 3 emissions since the GHG Protocol was first published in 2011. We believe data and methodologies have matured sufficiently in most sectors to enable disclosure of relevant, material categories of Scope 3 emissions.

We also recognise concerns around potential legal consequences arising from publication of forward-looking statements associated with transition plans and climate scenarios. ICGN supports the inclusion of safe harbour provisions to protect company officers and directors from liability related to these disclosures. This should provide comfort to companies and encourage full transparency to aid investor decision-making. This is contingent on proof of adequate processes and controls for reporting rigor. Over time, as data and methodologies become better established, the safe harbor provision could be removed or subject to sunsetting.

So, ICGN supports disclosure of emission reduction targets and the seven cross-industry metrics suggested by the ISSB. In terms of metrics related to the percentage of executive remuneration linked to climate targets, investors encourage better disclosure around how performance pay correlates with sustainability related KPIs, based on audited financial data.

Conclusion

To conclude, we have come a long way since the Paris Agreement in 2011, climate impacts on companies are still being mispriced, and consequently ignored in investment decision-making. We therefore hope we can overcome regional differences and welcome the introduction of globally harmonised sustainability standards becoming reality in the near future.

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