BlackRock.

Commentary

Sustainability Reporting: Convergence to Accelerate Progress

Over the past several years, BlackRock has been advocating for more widespread and standardized adoption of sustainability reporting. We believe that enhanced reporting is critical to the ability of companies and investors to take into consideration material environmental, social and governance (ESG) risks and opportunities. Company valuations can be significantly influenced by these factors, also known as intangibles. Better quality reporting and data would support more accurate asset pricing and enhance understanding of the drivers of risk and value in companies' business models.

Recognized private sector sustainability framework and standards setters recently committed to work together to establish a comprehensive corporate reporting system. The IFRS Foundation[1] is consulting on the role it might play in convergence towards globally recognized sustainability reporting. Further, international accounting and auditing standards setters have issued guidance that climate risk may be material for some companies and, if so, should be reflected in financial reporting under existing standards. As discussed below, **BlackRock strongly supports convergence to achieve a globally recognized and adopted approach to comprehensive reporting. In the meantime, we expect companies to accelerate their efforts to publish sustainability data and contextual information under existing frameworks and standards.**

BlackRock has been engaging with companies for several years on enhanced sustainability reporting, which we consider to be reporting aligned with the recommendations of the Task Force on Climate-related Financial Disclosure (TCFD) and the metrics identified by the Sustainability Accounting Standards Board (SASB). Some companies are already reporting to other standards, commonly the Global Reporting Initiative (GRI). In those cases, we ask that they map existing reporting to the metrics identified for their sector by SASB as being relevant to investment decision-making, given other standards address a broader group of stakeholders.

We consider SASB a globally relevant standard for reporting to investors because it is focused on achieving disclosure that is financially material, decision-useful, cost-effective, industry-specific, evidence-based and informed by market practitioners. Although initially US-oriented, over 40% of companies reporting against SASB are now based outside the US, a trend that we expect will continue. We see the TCFD framework and the SASB standards as complementary. TCFD is focused on climate-risk reporting but, in our view, is conceptually as applicable to all corporate reporting relating to environmental and social risks and opportunities. It has four pillars – governance, strategy, risk management, and metrics and targets. The SASB standards provide the content, principally for the metrics pillar. One of the key advantages of TCFD and SASB from an investor's perspective is that each is grounded in the language of business planning and operations. We expect both to be significant building blocks in the convergence effort.

BlackRock is encouraged by the increased use by companies of SASB metrics in their reporting, 3.4x higher in the nine months to September 30, 2020 on the full calendar year 2019. Similarly, TCFD is garnering significant support – from over 1,400 organizations representing a market capitalization of over $12.6 tn, as of September 2020. In addition, an increasing number of policy makers and stock exchanges around the world – such as the UK's Financial Conduct Authority and the New Zealand government - are recommending or mandating TCFD reporting.

We will continue to contribute directly to the development of TCFD and SASB through our engagement with each initiative. Both encourage feedback from companies and investors and work to enhance their recommendations and supporting tools. We will also actively engage in the efforts to converge frameworks and standards to achieve a comprehensive, globally recognized sustainability reporting system that will benefit companies by reducing the reporting burden and investors by improving the quality of data and narrative available to them for investment decision-making.

[1] International Financial Reporting Standards: https://www.ifrs.org/

Introduction

With the increased awareness of the materiality of environmental, social and governance factors to companies' long-term financial performance, investors and other stakeholders need a clearer picture of how companies are managing sustainability today and planning for the future. In January, BlackRock called for companies to enhance their sustainability reporting, highlighting that: "Important progress improving disclosure has already been made – and many companies already do an exemplary job of integrating and reporting on sustainability – but we need to achieve more widespread and standardized adoption."[2] We are encouraged that many more companies are publishing substantive disclosures on their management of environmental and social risks and opportunities, as discussed above. However, the proliferation of disclosure initiatives, many of which are overlapping, has led to duplicative efforts by reporters and a lack of consistent and comparable data. We believe that this could be resolved by aligning and converging to establish a globally recognized sustainability reporting framework and set of standards. Ideally, these would be developed by those with domain expertise in the private sector and supported by public policy makers as they move to require more comprehensive corporate reporting.

Efforts to develop a global approach to sustainability reporting

To that end, we welcomed the joint statement[3] on September 9, 2020 by a group of five sustainability reporting organizations - the Sustainability Accounting Standards Board (SASB), the Global Reporting Initiative (GRI), the International Integrated Reporting Council, the CDP (formerly the Carbon Disclosure Project) and the Carbon Disclosure Standards Board - that they plan to work together to develop "a comprehensive global corporate reporting system". The following week, the International Federation of Accountants (IFAC) called for the creation, under the umbrella of the IFRS Foundation, of an International Sustainability Standards Board, which would sit alongside the International Accounting Standards Board (IASB).[4] IFAC noted that there is a pressing need for a "reporting system that delivers consistent, reliable, adaptable and assurable information relevant to enterprise value creation, sustainable development and evolving expectations."

Adding to the mix, the World Economic Forum's (WEF) International Business Council (IBC), working with the Big Four accountancy firms, announced[5] on September 22, 2020 its own set of universal sustainability metrics for reporting that measures stakeholder capitalism. The IBC's stated objective was "to encourage greater cooperation and alignment among existing standards as well as to catalyze progress towards a systemic solution, such as a generally accepted international accounting standard in this respect." The WEF's corporate convening power makes its support of convergence important, in our view, particularly in relation to channeling corporate perspectives into convergence efforts driven by the recognized global standard setters.

In a consultation paper issued by the IFRS[6] Foundation Trustees on sustainability reporting published on September 30, the IFAC proposal was subsequently given as one option, along with IFRS taking no action or facilitating existing initiatives. **The consultation proposes that the IFRS Foundation establish a sustainability**

[2] https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter

[3] https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work-Together-Towards-Comprehensive-Corporate-Reporting.pdf

[4] https://www.ifac.org/news-events/2020-09/ifac-calls-creation-international-sustainability-standards-board-alongside-international-accounting

[5] https://www.weforum.org/press/2020/09/measuring-stakeholder-capitalism-top-global-companies-take-action-on-universal-esg-reporting/

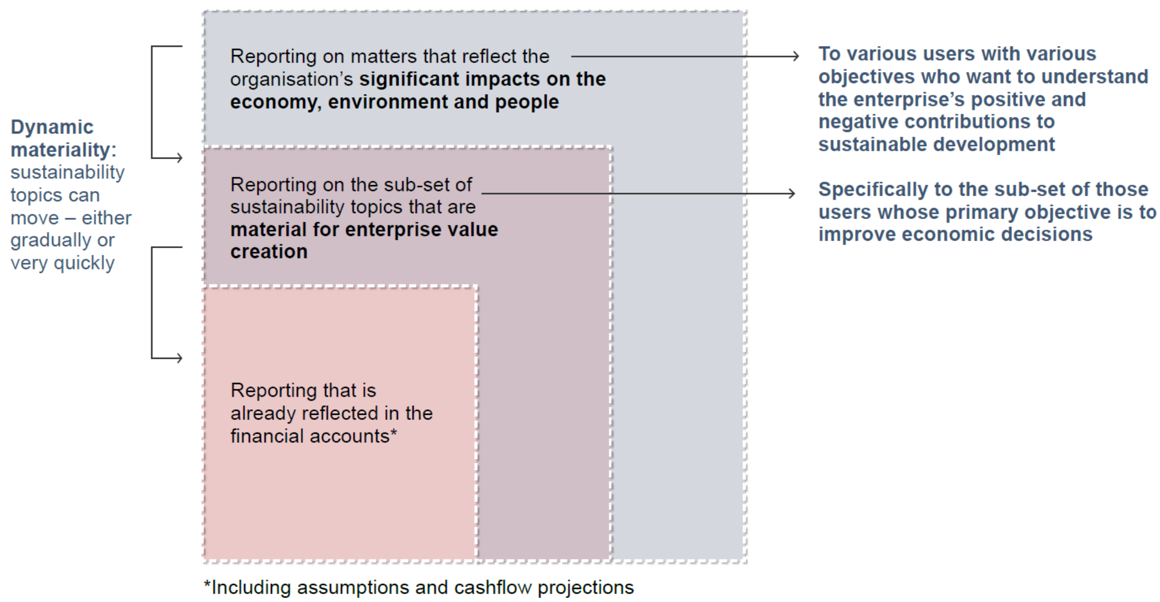
[6] International Financial Reporting Standards: https://www.ifrs.org/

standards board and become a standards-setter working with the existing initiatives and building upon their work. BlackRock believes this would be the optimal outcome and plans to submit a response to the consultation by the deadline of December 31, 2020.

A changing understanding of materiality

The group of five organizations introduced the concept of nested materiality (see Figure 1 below) to explain the gradation between core financial information already reported in financial statements, to ESG information relevant to enterprise value creation, to information on the impact on society of a company's operations, products and services. Similarly, the European Union's concept of double materiality addresses the importance of reporting both the economic and societal impacts of companies. Also captured within the concept map produced by the partnering organizations is the concept of dynamic materiality, whereby the factors recognized as material change over time based on facts and circumstances as well as increased understanding of the drivers of risk and value in a company's business model. Dynamic materiality resonates with BlackRock, particularly in terms of the sector-specific factors and information necessary for the different audiences that companies are trying to address in their reporting.

Figure 1: Dynamic, nested materiality



Source: SASB et al

Progress in sustainability reporting as we move towards a global standard

The momentum behind convergence towards a global standard for sustainability reporting is significant but it will take time to realize the objective. BlackRock envisages a two-track approach to reporting in the near term with companies, investors and others contributing to efforts to achieve convergence, while simultaneously making progress on enhanced reporting under the existing frameworks and standards. Two important announcements from the IASB, whose financial reporting standards are followed in over 140 jurisdictions,[7] and the International Auditing and Assurance Standards Board (IAASB) on climate risk support the latter work.

In a recent paper,[8] the IASB noted that companies may need to take climate risk, including the impact of a transition to a low carbon economy, into consideration in the materiality judgments underpinning their financial statements. This guidance is based on the public and growing recognition by investors that climate risk is a material investment risk, particularly for companies in carbon-intensive sectors. Similarly, the IAASB's recent audit practice alert on climate-related risks[9] notes that "… climate-related events or conditions may contribute to the susceptibility to misstatement of certain amounts and disclosures in an entity's financial statements." Under the concept of dynamic materiality, this interpretation may eventually cover additional sustainability factors material to a company's business model as measurement capabilities improve.

Thus, we anticipate that companies will increasingly be expected, under existing accounting and audit standards and processes, to take climate risk into consideration in preparing financial statements. Assumptions and materiality judgments that are inconsistent with a company's stated position on the transition to a low carbon economy may be challenged by investors, auditors and regulators, and therefore ought to be explained and justified. **Given the recognition of the materiality of sector-specific sustainability risks to long-term investment returns, we expect increased investor scrutiny of the assumptions underlying financial reports, with concerns reflected in engagement and voting.**[10]

The accuracy of financial statements is clearly of paramount importance to investors. Financial reporting should reflect reasonable assumptions about the impact of climate risk and the transition to a low carbon economy[11] on the company's profits, liabilities and assets. If they do not, and thus may be misleading, BlackRock would reflect our concerns about management's assumptions in our votes on the financial statements, approval of the auditor or election of directors.

Conclusion

BlackRock strongly advocates for convergence of the different private sector reporting frameworks and standards to establish a globally recognized and adopted approach to sustainability reporting. We see the approach proposed by the IFRS Foundation as the most practicable and likely to succeed. We believe a combination of the best ideas would minimize the reporting burden on companies and achieve the optimal results for users of company reporting on sustainability. It may take some time to achieve the objective of a global sustainability reporting framework and supporting standards. Nonetheless, there is enough substantive guidance, including from the international reporting and auditing bodies, to support significant progress in the number of companies reporting and the quality and consistency of the information they disclose. BlackRock will continue to advocate for TCFD and SASB-aligned reporting until a global standard is established. Progress will help investors like BlackRock better understand a company's approach to enterprise value creation and, in turn, more effectively allocate capital across our investment universe to align with delivering the long-term sustainable financial returns on which our clients depend.

Contact BlackRock Investment Stewardship at contactstewardship@blackrock.com

---

[7] https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/

[8] https://cdn.ifrs.org/-/media/feature/news/2019/november/in-brief-climate-change-nick-anderson.pdf?la=en

[9] https://www.iaasb.org/news-events/2020-10/iaasb-issues-staff-audit-practice-alert-climate-related-risks

[10] https://www.unpri.org/sustainability-issues/accounting-for-climate-change

[11] That is, one in which global warming is limited to well below 2°C, ideally 1.5°C, and is consistent with a global aspiration to reach Net Zero carbon emissions by 2050.