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To: Jean-Paul Gauzès, EFRAG Board President and Chairman of the European Lab Steering Group

From: Janine Guillot, CEO, SASB Foundation

Re: SASB's response to preliminary proposals resulting from the European Commission's ad personam mandate on non-financial reporting standard setting

Dear Mr. Gauzès:

The Sustainability Accounting Standards Board (SASB) appreciates the opportunity to provide our views on the important work being undertaken by the European Financial Reporting Advisory Group (EFRAG) in the area of non-financial reporting. We believe EFRAG, with the support of the European Commission, can play a leading and important role in ensuring a coherent, comprehensive, global solution for corporate reporting standards that meets the needs of multiple users, including policy makers, companies, investors, employees, consumers, and civil society organizations.

Overview

As governments around the world look to align with the Sustainable Development Goals (SDGs) and countries work to fulfill their nationally determined contributions (NDCs) to global climate goals, there is increasing recognition that global capital markets have a significant role to play in enabling a transition to a more sustainable, resilient, and low-carbon economy. Company disclosure is an important lever to enable businesses, the investment community, consumers, policy makers, and other stakeholders to evaluate performance in this regard.

Today's businesses have global supply chains, face global risks, and have global investors. Similarly, today's investors manage global portfolios and need comparable information across all their portfolio companies. In the absence of a globally accepted approach to sustainability disclosure, key market actors will continue to face significant challenges in reporting and using disclosed information, slowing the ability of markets to contribute to progress.

Despite this need for a globally coordinated solution for capital markets, a diversity of reporting objectives and approaches continue to proliferate, threatening to increasingly fragment an already complex patchwork of mandatory and voluntary initiatives internationally. This dilemma highlights an essential point: To be effective, a comprehensive corporate reporting system must meet multiple objectives—it must provide a foundational disclosure solution for global capital markets and also enable jurisdictional flexibility to meet broader societal aims, including those related to specific jurisdictional policy objectives. Such a system of corporate reporting must therefore necessarily accommodate differing degrees of ambition across international markets.

SASB believes EFRAG and the EU can play a significant role in helping establish this system. By using a "building blocks" approach—like that outlined in the *Statement of Intent to Work Together Towards Comprehensive Corporate Reporting* recently issued by the "group of five" standard-setters and framework providers—we believe EFRAG's efforts can help bring clarity, global consistency, and reduced complexity to a fragmented landscape.

A Shared Vision

In September 2020, five global organizations—CDP, the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC), and SASB—announced a shared vision for a comprehensive corporate reporting system and our commitment to collaborate to achieve it. In our joint *Statement of Intent to Work Together Towards Comprehensive Corporate Reporting*, we suggested a "building blocks" approach that recognizes the importance of structural connectivity between several types of reporting, including financial and "non-financial" reporting. Crucially, under the banner of "non-financial reporting," we see important distinctions that we believe will require different approaches, thus necessitating key "building blocks":

- **Block 1:** The first block of information addresses significant sustainability-related impacts that affect a company's financial performance or risk profile, and which therefore *drive enterprise value* over the short, medium, and long terms. This information, which we term "sustainability-related financial disclosure," is primarily relevant to economic decision making by users such as investors and other providers of financial capital.
- **Block 2:** The second block of information covers all of a company's significant sustainability impacts—i.e., on the economy, environment, and people—and their importance to its key stakeholders. The resulting information, which is often referred to as "sustainability reporting," thereby provides a comprehensive picture of a company's *positive and negative contributions to sustainable development* and can serve a broad range of users and objectives.
- **Block 3:** The third building block represents information related to specific *jurisdictional requirements* intended to support local public accountability and public policy objectives, insofar as they are not addressed via the first and second building blocks.

As we will discuss in more detail in the following sections, we believe a "building block" approach can meet the need for globally consistent disclosures for capital markets, while preserving jurisdictional sovereignty to address specific policy priorities. Such an approach would help foster collaboration, acceptability, and adoption across a broad range of jurisdictions internationally.

Thus, we are collaborating with all parties to achieve a comprehensive, coherent corporate reporting system that can deliver these building blocks, providing a broad spectrum of stakeholders—from policy makers and civil society to companies and investors—with the high-quality information they need to make effective decisions consistent with their objectives.

Different Blocks, Different Needs

SASB believes each of the three building blocks that comprise "non-financial reporting" will require its own unique approach to standard setting and governance, due to key differences in objectives, scopes, primary users, and applications.

For Block 1, which is focused on drivers of enterprise value, our emphasis is on the features of standard-setting that specific institutional arrangements would need to achieve. The characteristics of standard-setting we believe to be important are:

- Globally applicable standards, based on participation in the standards development process by global companies, investors, and other subject matter experts
- High-quality, independent due process
- Legitimacy from public oversight
- Appropriate representation of preparers and users in the both the governance structure and standards development process to ensure that standards are fit-for-purpose for their intended use

Given the need for a global solution for capital markets, we believe Block 1 disclosure should ideally rely on internationally accepted standards, as described below.

For Block 2, which is focused on contributions to sustainable development, we believe a globally accepted solution following a process similar to that outlined above would be ideal. However, we also acknowledge the differing perspectives of regulatory jurisdictions around the world in terms of their degrees of ambition, the specific issues they may choose to prioritize, and the political appetite or practical feasibility of mandating such disclosure. For this reason, we believe EFRAG has the opportunity to establish an important precedent for Block 2 that could help shape related efforts internationally.

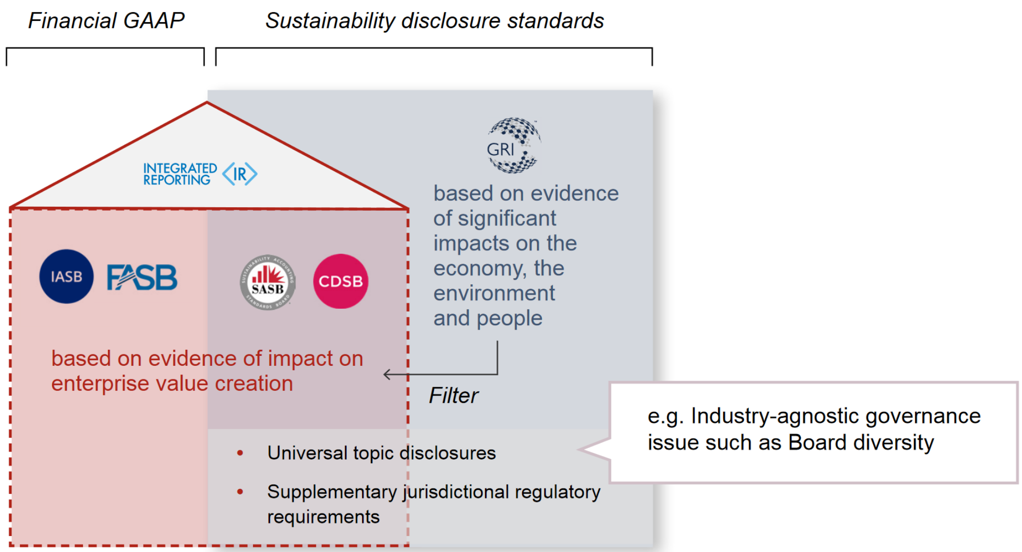
Finally, for Block 3, we recognize the importance of jurisdiction-level overlays, which can ensure that global standards are complemented by any additional disclosure requirements needed for achievement of specific policy objectives—for example, those related to the EU Taxonomy. In this area, EFRAG is well situated to extend the European Union's leadership role in sustainable finance by establishing structures, processes, and capabilities for use in the EU that can also be prototypes for use around the world.

Indeed, the European Commission has been both leader and powerful catalyst for all three of these building blocks. Along with our colleagues in the "group of five" framework providers and standard setters, we wish to work with EFRAG and the Commission to determine the most efficient and effective path forward to achieve a comprehensive, coherent solution that meets multiple needs and balances international consistency with regional flexibility.

A Path Forward

As illustrated by the shared vision outlined in the "group of five's" *Statement of Intent*, the core components of a coherent, comprehensive corporate reporting solution already exist. (See Figure 1.) A next step is to integrate these components where appropriate, achieve interoperability among them, and tailor this core for jurisdictionally specific objectives.

Figure 1. A Shared Vision for a Comprehensive Corporate Reporting System[1]



SASB believes EFRAG and the EU can be leaders in accelerating progress toward a globally accepted, comprehensive corporate reporting system. For example, EFRAG could adopt or endorse existing international standards and frameworks, as appropriate, on an interim basis, with an acknowledgement that companies should use them on a comply-or-explain basis. This would primarily address disclosure related to Blocks 1 and 2 but would also have important implications for Block 3 standard-setting.

- **Block 1:** Within the first block of sustainability disclosure focused on the intersection between sustainability and enterprise value, it is important to observe that significant developments are underway to establish a globally accepted solution. These include the collaborative work of the "group of five," organizational consolidation (e.g., the merger of SASB and the IIRC into the Value Reporting Foundation), and the proposed creation of a Sustainability Standards Board underneath the IFRS Foundation. By supporting some or all of the existing efforts, EFRAG and the EU could significantly accelerate progress toward a global solution for providers of financial capital. Such an approach would increase the likelihood of international adoption and uptake, while also ensuring accelerated progress toward global goals by creating a globally coherent baseline for information material to enterprise value creation.

  Such an approach would also enable EFRAG to strike an important balance between rigorous due process and timely outcomes. As demonstrated by the "group of five" in the December 2020 publication *Reporting on Enterprise Value*, standards for Block 1 disclosure may be rapidly developed by integrating the relevant components of existing standards and frameworks, including the recommendations of the Task Force on Climate-Related Financial Disclosure.

[1] Source: CDP, Climate Disclosure Standards Board (CDSB), Global Reporting Initiative (GRI), International Integrated Reporting Council (IIRC) and Sustainability Accounting Standards Board (SASB), Statement of Intent to Work Together Towards Comprehensive Corporate Reporting (September 2020).

- **Block 2:** Within the second block of sustainability disclosure focused on contributions to sustainable development, EFRAG and the EU have an opportunity to further develop the concept of "double materiality" that was established in the European Commission's 2017 Non-Binding Guidelines on Non-Financial Reporting by developing an explicit definition of "environmental and social materiality" and establishing clear disclosure expectations regarding environmental, social, and economic impacts. Of the "group of five", the Global Reporting Initiative (GRI) has long demonstrated expertise and global adoption in this area, and we suggest that EFRAG work closely with GRI in this regard. Focusing on clarifying definitions and disclosure expectations for "environmental and social materiality," as the term is used in the NFRD guidance, would allow the EU to set a global precedent for establishing standards focused on the second aspect of the "double materiality" continuum.

  Additionally, given the dynamic nature of sustainability issues, it will be essential for EFRAG to consider how its work in Block 2 can help support "building a bridge" to achieve interoperability between standards focused on drivers of enterprise value and broader standards that reflect an organization's significant impacts on the economy, environment, and people.

- **Block 3:** Finally, within the third block, EFRAG could prioritize the development of key jurisdictional requirements, should existing efforts in Blocks 1 and 2 fail to satisfy the EU's policy priorities in a way that is timely or fit for purpose. This includes the specific disclosure requirements associated with the EU Taxonomy. As noted above, it is essential that there are globally accepted standards that ensure comparability of a baseline, core set of information for the global capital markets. However, at the same time, it is equally essential to allow for jurisdictional extensions and amendments, as necessary, to support national or regional policy priorities (e.g., the EU's sustainable finance agenda), foster innovation, and thereby develop and test approaches that may be suitable for global adoption and dissemination.

Practical Considerations

In taking a "building blocks" approach, EFRAG would likely need to develop a unique structure and due process to accommodate the full breadth of "non-financial reporting" objectives and users, along with appropriate governance and oversight. SASB believes this could be achieved under the proposed two-pillar structure within EFRAG for financial and "non-financial reporting." We believe the new "non-financial" reporting pillar within EFRAG could be responsible for Blocks 1, 2, and 3, with tailored processes for each Block that blend endorsement capabilities with direct standard-setting capabilities.

For example, for Block 1 (and potentially Block 2), EFRAG would need to participate in the development of international standards and would also need an endorsement process to evaluate the resulting standards for use in the EU. EFRAG could base Block 1 (and potentially Block 2) standard-setting on a model similar to that which it uses for international financial reporting standards.

For Block 2, as noted above, we believe EFRAG should shape the foundational principles and processes for standards focused on the second ("environmental and social") aspect of the "double materiality" concept. For example, the European Corporate Reporting Lab could play an important role in defining "environmental and social materiality," piloting specific disclosure requirements for both companies and investors, and helping support the “building of a bridge” of interoperability between sustainability-related financial disclosure (Block 1) and traditional sustainability reporting (Block 2). As noted earlier, we believe EFRAG should work closely with GRI in this regard.

For Block 3, EFRAG would need to develop direct standard-setting capabilities, which will require their own due process.

Regardless of whether EFRAG ultimately uses an endorsement model, a direct standard-setting model, or a hybrid of the two, non-financial standard setting activities would require new processes and technical expertise beyond that which currently exists at EFRAG. This would in turn require the expansion of the EFRAG General Assembly and the incorporation of relevant expertise into the EFRAG Board, the Non-Financial Reporting Board, the Technical Experts Group, and the working groups.

The governance structure and due process(es) would need to involve a balanced, and transparently selected mix of representatives from the private sector and civil society—e.g., report preparers, investors, key advisors, and NGOs—to ensure outcomes that are of high quality and optimal utility, to ensure that decisions are influenced by both policy and technical considerations, and to minimize the likelihood of any one group of stakeholders exercising undue influence over the process. Such balanced representation should apply to all levels of the EFRAG structure and across all three blocks of “non-financial reporting.”

Finally, both the structure and due process(es) developed for the “non-financial reporting” pillar could involve appropriate representation from existing, international standard setters in order to draw on their experience and expertise. EFRAG could also explore how it, and/or the European Commission, could be more involved in the international standard setting initiatives to ensure the compatibility of efforts and outcomes.

Conclusion

SASB strongly supports the European Commission’s objective of providing decision-useful “non-financial” information to market participants, policy makers, civil society, and others. We believe expanding EFRAG’s mandate could complement and accelerate other concurrent efforts, helping set the stage for a coherent, comprehensive system of corporate reporting that is both globally accepted and flexible enough to accommodate the breadth of ambitions and policy objectives among jurisdictions internationally. We applaud the European Commission’s important leadership in driving toward such a solution, and we welcome further engagement as all parties work to ensure our common future is a prosperous one in Europe and beyond.

Kind regards,

Janine Guillot
CEO, SASB Foundation