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ISSB Could Help Unify Fragmented Sustainability Standards

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Fitch Ratings-London/Barcelona-17 September 2021: The proposed International Sustainability Standards Board (ISSB) could prompt consolidation in the disclosure of financially material sustainability information by corporates and financial institutions within a globally accepted framework, Fitch Ratings says. The large-scale adoption of International Financial Reporting Standards (IFRS), their familiarity and widely accepted credibility makes the expected ISSB launch a significant event that could facilitate widespread and consistent sustainability disclosures across sectors, although their efficacy would depend on ISSB standards' final form and their implementation by regional and national authorities.

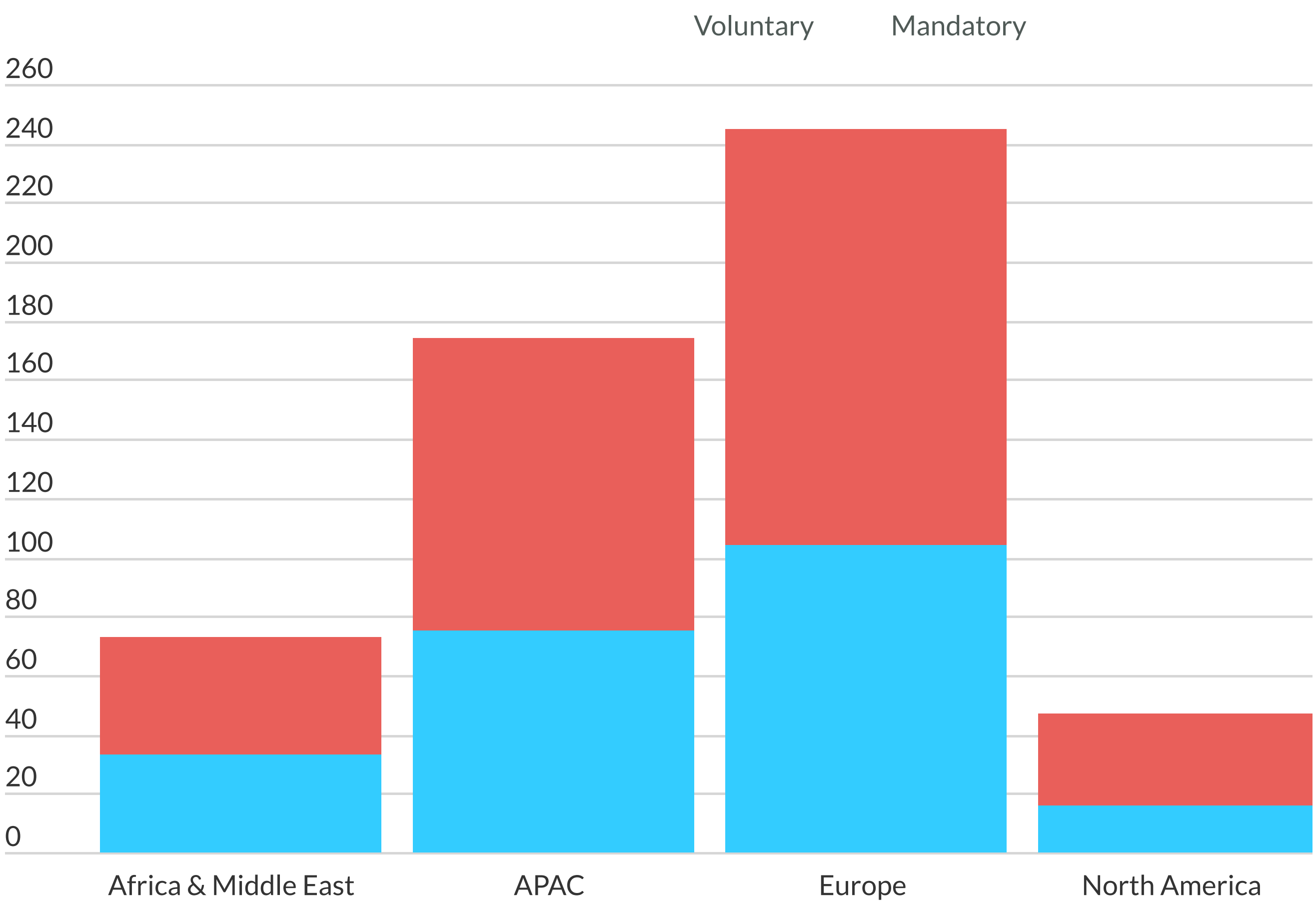
The IFRS Foundation oversees the IFRS as accounting standards applied in about 140 countries, notably in Europe and Asia. It has proposed the creation of the ISSB, whose launch is expected at November's COP26 summit. The proposal sees the ISSB sitting alongside the International Accounting Standards Board (IASB) to ensure interconnectedness between accounting and sustainability-related requirements. The sustainability standards will aim to capture financially material information about companies' sustainability-related risks and opportunities, and their impact on enterprise value, with an initial focus on climate-related risks.

Lack of standardised or widely used frameworks for ESG and sustainability assessments, or data to support analysis of financially material ESG risks for companies and financial products, are widely cited hindrances by investors; a 2019 survey by Franklin Templeton found these were the top two concerns. If embraced globally, ISSB could make sustainability standards less complex and speed up the adoption of sustainability reporting by corporates, financial institutions and other entities.

Sustainability reporting is increasingly mandatory rather than voluntary, but the standards for reporting, from climate-related issues to allocation and impact reporting, are lengthy and often unrelated to those in other jurisdictions. This can be onerous for the entities reporting and make it difficult for users to interpret the information reported. Sustainability reporting is often an add-on to financial statements, included in very broad statements or policies or buried deep in annual reports.

Voluntary and Mandatory Sustainability Reporting Provisions, by Region

Number of reporting instruments, 2020



Source: Fitch Ratings, www.carrotsandsticks.net

Uniform and comprehensive sustainability data based on a common standard can enhance understanding of the interaction between financial and sustainability factors, and their effect on the integrity of assets and earnings across sectors. This will be especially so if ISSB disclosures become mandatory in national jurisdictions.

For asset-backed securities and covered bonds, Fitch has flagged data availability, transparency and comparability as a key challenge to market growth. To the extent that earmarked sustainable assets for pools become available, this would lead to more sustainability-related issuances.

Key Challenges to Growth of Green RMBS a

Category	Challenges
Data limitation	• Varying data coverage of national registries • Limited EPC comparability across countries
Physical	• Old housing stock in most European countries and lo • High cost of deep renovation
Assets	• Limited inventory of green assets • EPCs are becoming a requirement for loan originatio underwriting • Housing availability, location and size are still the ma
Progress	• According to the European Commission's assessmen there is still much to be done on energy efficiency for b • Unification of standards

Source: Fitch Ratings

We think the ISSB could rapidly become the dominant standard setter and would build on the work of global ESG and sustainability standards setting organisations, which include the Value Reporting Foundation, the Global Reporting Initiative, Carbon Disclosure Project and the Climate Disclosure Standards Board, as well as the Task Force on Climate-related Financial Disclosures framework. It will also benefit from the historical build-up of accounting standards at its sister organisation the IASB.

Fitch expects sustainability standards to evolve more quickly (standardising accounting standards took several decades), given the existing infrastructure and standardisation work that the ISSB can build on, and the sense of urgency around coherent sustainability standards, particularly regarding climate change. It is also likely that the US Financial Accounting Standards Board would implement similar changes.

The ISSB concept has been widely embraced by governments and regulators, including the G7 finance ministers and central banks, but there are important uncertainties around adoption and adherence prospects, particularly relating to different definitions of sustainability in different jurisdictions. In addition, a baseline that is widely accepted may not fully capture the potential of financially material issues to ensure a broad-based appreciation of risks. Greater clarity will emerge as technical work around sustainability standard-setting begins in 2022.

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