

Response to IFRS Foundation Consultation Paper on Sustainability Reporting
From Morningstar Inc. and Sustainalytics, a Morningstar Company

Submitted by email to commentletters@ifrs.org
22nd December 2020

Dear Sirs,

Morningstar welcomes the opportunity to comment on the proposed standards-setting of sustainability reporting. We bring several perspectives to this comment letter. First, we have a long track record of categorizing and rating mutual funds that pursue different sustainability strategies. Second, our equity analysts use environmental, social, and governance (ESG) analysis as part of their approach to assessing investments. Third, Sustainalytics, which is now part of the Morningstar family, is a leading global provider of ESG ratings, research and data to asset owners, investment managers, financial institutions, issuers/corporates, and a variety of other financial intermediaries.

Question 1 Is there a need for a global set of internationally recognised sustainability reporting standards? (a) If yes, should the IFRS Foundation play a role in setting these standards and expand its standard-setting activities into this area? (b) If not, what approach should be adopted?

A base level of standardized, consistent and comprehensive sustainability information is a critical minimum requirement for investors to be fully informed in their investment decision-making and necessary to provide guidance to issuers/corporates. In Morningstar's view, the IFRS Foundation, in light of its standard-setting experience and expertise, due process procedures focused on transparency, broad consultation and accountability, strong governance structure, and widespread acceptance of the International Accounting Standards Board, is ideally placed to take a lead in setting sustainability reporting standards. Morningstar believes that IFRS should focus initially on the investor user and on the intersection between sustainability and the creation of enterprise value.

Question 2 Is the development of a sustainability standards board (SSB) to operate under the governance structure of the IFRS Foundation an appropriate approach to achieving further consistency and global comparability in sustainability reporting?

A SSB, operating as an equal and parallel body to the IASB, is a logical approach to achieving more consistency and comparability in sustainability reporting. The IFRS and IASB has a proven governance structure and a track record of positive and constructive engagement across a spectrum of stakeholders. We recommend that IFRS include significant investor representation in both the Foundation and the SSB governance structure.

Question 3 Do you have any comment or suggested additions on the requirements for success as listed in paragraph 31 (including on the requirements for achieving a sufficient level of funding and achieving the appropriate level of technical expertise)?

Morningstar recommend

- a. amending criteria (b) to prioritise getting recognized leading markets on board first;
- b. amending criteria (d) to include a reference to soliciting and leveraging appropriate industry expertise from practitioners and existing organizations that develop sustainability disclosure standards, which require a broader knowledge set than that used for financial accounting standards development.
- c. adding a criterion around forming some kind of framework in which existing standards bodies contribute and operate within.

Question 4 Could the IFRS Foundation use its relationships with stakeholders to aid the adoption and consistent application of SSB standards globally? If so, under what conditions?

The IFRS' global reach is one of the reasons, together with the other attributes we refer to in our response to question 1, is a key factor in why it is well placed to assume this standard setting role. IFRS stakeholders are already familiar with the importance and application of accounting standards and should be invited to contribute their expertise to an SSB, whether in the design, implementation or acceptance of sustainability standards.

Question 5 How could the IFRS Foundation best build upon and work with the existing initiatives in sustainability reporting to achieve further global consistency?

We suggest approaching this by identify which existing initiatives offer the best solution to each component part of sustainability reporting. As highlighted in our response to Question #1, Morningstar believes that IFRS should initially narrow its focus on those standards and frameworks that address sustainability from the perspective of enterprise value creation and should address the full range of sustainability (ESG) factors that are material to enterprise value creation (not only focus on climate change). Accordingly, we recommend that IFRS prioritize relationships initially with existing and credible organizations with this mandate - namely TCFD and SASB. By leveraging their expertise and experience, the SSB would avoid duplication and accelerate its work. As IFRS expands its reach to focus on sustainability impacts and outcomes, it should leverage organizations such as the GRI.

Question 6 How could the IFRS Foundation best build upon and work with the existing jurisdictional initiatives to find a global solution for consistent sustainability reporting?

We would suggest the starting point be to engage with leading bodies in this space, including the European Commission; the International Platform for Sustainable Finance; and IOSCO. A core goal should be to ensure that the reporting obligations of issuers are aligned with, and can be rolled up to, those of the institutions and financial products that invest in them. Another key consideration should be how to approach standardisation of aspects where detailed regulatory reporting requirements are already enacted, such as the Sustainability Finance Disclosure Regulation in the EU.

Question 7 If the IFRS Foundation were to establish an SSB, should it initially develop climate-related financial disclosures before potentially broadening its remit into other areas of sustainability reporting?

As explained above, Morningstar believes that IFRS should focus initially on the investor user and on the intersection between sustainability and the creation of enterprise value. It should address the full range of sustainability factors that are material to enterprise value creation (e.g. environmental, social, and governance disclosures). Climate change is too narrow a focus, even as a starting point.

Question 8 Should an SSB have a focused definition of climate-related risks or consider broader environmental factors?

We would advocate for broader environmental issues than climate-related risks to be considered by an SSB. The EU taxonomy, for example, is already at an advanced stage of definition, with issuers and financial products scheduled to begin climate adaptation and climate mitigation activity disclosures at the end of 2021, and 1 year later for four other environmental categories. The longer that this, and other taxonomies, continue to develop independently and be used more prevalently, the more difficult, time-consuming and expensive will be the efforts to align them. At the same time, the expense for corporations will increase, both in terms of conforming to different requirements and in terms of preparatory spend being redundant if and when the reporting requirements change. And until an end-state is agreed upon, investors will continue to suffer from a lack of comparable sustainability information.

Question 9 Do you agree with the proposed approach to materiality in paragraph 50 that could be taken by the SSB?

It is not clear to us exactly what a focus on ‘the sustainability information most relevant to investors and other market participants’ means in the context of materiality. It could be taken to mean a focus on material sustainable risks and exclude any aspects of adverse impacts that activities or investments have on sustainability. Or it could be referring to identifying and dealing with the most financially material important aspects of each. Further, paragraph 50 does not indicate any time horizon for what is meant by ‘initially’. The IFRS should acknowledge from the outset that “double materiality” is within its scope and should commit to create standards that encompass sustainability impact and outcomes, setting out a roadmap, including timelines, for this next stage of work.

Question 10 Should the sustainability information to be disclosed be auditable or subject to external assurance? If not, what different types of assurance would be acceptable for the information disclosed to be reliable and decision-useful?

Yes, Morningstar advocates for assurance to help enforce standards and build confidence in sustainability information. We recommend a progressive approach, starting with a focus on an identified set of core metrics across the full range of sustainability factors that are material to enterprise value creation. We also are comfortable with an acknowledgement that companies should use them on a comply or explain basis.

Question 11 Stakeholders are welcome to raise any other comment or relevant matters for our consideration.

No comment.

On behalf of Morningstar we again thank you for the opportunity to contribute and will be happy to engage further, answer any questions or provide any additional information that may be helpful.

Yours faithfully,

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