POLICY BRIEF
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DOMESTIC POLITICS AND SUSTAINABILITY REPORTING

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Key Points

- There are a variety of domestic approaches to corporate sustainability and climate-risk reporting. Analysis of the differences in these approaches appears to be lacking in existing research.
- Domestic reporting approaches differ along seven central policy themes: legal environments, chosen reporting format, the established boundary of reporting companies, the type of disclosure content, the applied disclosure approach, the intended audience and report verification mechanisms.
- In considering the recent report by the Task Force on Climate-related Financial Disclosures (TCFD) of the Financial Stability Board (FSB), the TCFD should be aware of broader conceptions of corporate sustainability, more rigorous disclosure requirements and the challenges of applying materiality to non-financial information disclosure.

Introduction

The emergence of the FSB's TCFD represents a significant opportunity to clarify the existing complex regime of standards that govern climate change risk disclosure in the global economy. The TCFD recently released its first report outlining the objectives and scope of its work. The report included a review of existing climate change risk disclosure standards "to identify commonalities and gaps across existing regimes and areas that merit further work and focus by the Task Force" (FSB 2016). This review is an important exercise as most international financial standards build from existing standards that are already in practice.

There are over 400 standards currently used throughout the global economy. Sustainability and climate change risk disclosure, however, are distinct compared to other areas of financial regulation, such as standards for banking, accounting and insurance, which can rely on existing regulatory frameworks developed by states. Private actors, such as non-governmental organizations (NGOs) and private firms, are more involved in the development and implementation of standards for sustainability and climate change, which creates a challenge for the TCFD and the FSB. The adoption of financial regulation at the domestic level provides a starting point for the development of international regulation. International financial regulations, such as International Financial Reporting Standards developed by the International Accounting Standards Board, are more likely to be adopted by governments that have adopted similar domestic approaches, based on lower costs of compliance.

Unfortunately, research on domestic approaches to sustainability and climate change risk disclosure does not currently provide a comprehensive analysis of national differences in disclosure practices. Existing international analyses often categorize companies with respect to their size. For example, economic boundaries such as the Global Fortune 250 (G250) and

N100[1] are often used when assessing sustainability reporting (see KPMG 2015), as opposed to geographical boundaries. There is a minimal understanding of the trends within countries, specifically of those companies not included in large economic groups (Buhr, Gray and Milne 2014). Ian Thomson (2014), in his content analysis of accounting and sustainability literature, found that international boundaries were a common area of research, while assessment of state laws and policy making were quite uncommon topics of study. Thus, there appears to be a gap whereby the national differences in sustainability reporting are neglected in favour of more common economic and international categories.

The objective of this policy brief is to assess national variations in the sustainability and climate change risk disclosure as a means of informing the TCFD's development of an international standard. The first section will examine existing research that can be used to compare current domestic approaches to sustainability and climate change risk disclosure. The second section will use this framework to assess a range of disclosure approaches from South Africa, France, the United Kingdom and Canada. The third section will synthesize these findings and develop some policy recommendations for the TCFD based on this analysis.

Background

Although research on national approaches to sustainability reporting is emerging, national differences in institutions and domestic politics have long been associated with different approaches to financial regulation. National history, industries, regulatory agencies, and the politics and preferences of national institutions are often cited as an explanation for the interests of different governments that are involved in international financial regulatory negotiations. For example, David Andrew Singer (2007) identifies the preferences of domestic regulators that take positions on international financial regulation to preserve their autonomy from legislative oversight during major crises. Domestic opposition among interest groups affected by the costs of international regulation has also been identified as a factor explaining national interests toward financial regulation. Similarly, domestic actors that benefit from changes in international financial regulation can also influence national positions on financial regulation (Helleiner and Pagliari 2011).

The influence of domestic politics on financial regulation justifies further exploration of existing approaches to sustainability and climate change disclosure practices, as they offer insights into domestic preferences that could be exercised to influence the emerging international regime. There is, however, significant diversity in the governance of sustainability reporting at the national level. Some countries have mandated sustainability reporting through financial reporting standards, stock exchange listing requirements or other policy measures, such as adopting corporate governance codes. Other countries have decided to leave sustainability disclosures at the discretion of the company, to be included as a material disclosure in financial reporting if it is of concern to investors, or in a voluntary corporate social responsibility report for interested stakeholders. Some governments have decided to suggest existing voluntary sustainability reporting standards as guidelines to follow, exemplifying a hybrid policy approach. These reporting models reveal a spectrum of policy approaches (Buhr 2010; Herzig and Schaltegger 2011).

Domestic Approaches to Sustainability and Climate Change Risk Reporting

To compare different approaches, it is important to briefly review some themes common to literature on sustainability and financial reporting.

Literature often discusses the policy creation process — in particular, the history, context and national circumstances — that initially motivated sustainability reporting (Adams and Kuasirikm 2000; Buhr and Freedman 2001; Visser and Tolhurst 2010). The circumstances of policy development are important to consider in order to understand the initial motivations and purpose of sustainability reporting in a jurisdiction.

Due to the differences in national legal systems, local customs and political environments, reporting policy can be motivated through a variety of actors and institutions. Evidence in the financial reporting literature suggests that domestic institutions and politics matter when assessing corporate reporting (Fioretos 2010; Quaglia 2010). In addition, national financial structures, legal environments and culture can influence the extent and the content of sustainability disclosures (FSB 2016). Understanding domestic factors will thus be outlined in this assessment of sustainability reporting. South Africa, for example, saw the King Code of Governance as a way to create corporate transparency in tandem with a new post-apartheid political system, while also attracting foreign capital to make South Africa a leading developing economy (Eccles and Krzus 2014).

Studies often discuss reporting format, due to the variety of approaches companies currently use when issuing sustainability and climate change disclosures (Jensen and Berg 2012; Eccles and Krzus 2014). Understanding what

1 The G250 are the largest companies in the world by revenue. The N100 are the largest 100 companies in 45 countries by revenue, totalling 4,500 companies (KPMG 2015).

report format a policy promotes is important, as this may impact the function of the report, and the audience for the information (SASB 2015). There are three main approaches to the report format. Most corporate social and environmental reports are included as addendums to the traditional annual report (common in Europe), There are also stand-alone reports, where corporate sustainability information is located in a separate report (common in North America). Integrated reports represent a third approach, whereby sustainability and financial information is integrated into one report, centred on long-term value creation through different types of capital. This approach has gained popularity as a way of simplifying the opportunities for interpretation of data by end-users. Financial and sustainability information that is combined helps establish whether there are links between an organization's business and company strategy and its social and environmental performance.

The type of companies participating in sustainability reporting varies among countries. For example, some laws may only apply to publicly listed companies, while others will apply to publicly listed, private and/or state owned companies. Other jurisdictions restrict reporting to companies that exceed a certain revenue threshold. Reporting is most common among large, publicly traded companies, which are influenced by their increased exposure to reputational risk. Small to mid-sized companies, and companies in emerging economies, are untapped markets for sustainability reporting.

Report content is often discussed in sustainability reporting, specifically within comparative analyses of reports and their respective governing policies (Morris and Badache 2012; van Wensen et al. 2011; van der Esch and Steurer 2014). Reports can include guidance that emphasizes certain sources of information over others, such as economic, environmental or social disclosures. In climate change risk disclosure, for example, some reports would like details on how climate change is influencing company strategy, whereas others focus explicitly on tracking greenhouse gas (GHG) emissions. Report content has become a source of debate between investors and accountants and sustainability reporting advocates. Investors and accountants support content that is relevant to a company's financial performance, whereas the advocates seek a broader range of information relevant to non-financial stakeholders, such as NGOs and consumers.

Sustainability reporting also offers different approaches to the disclosure guidance. For example, organizations such as the Global Report Initiative (GRI) and governmental bodies such as the European Union have expressed support for the "report or explain" approach, whereby companies choose to disclose their performance based on a reporting framework or standard, explaining any sustainability information they choose not to disclose (GRI and UN Environment Programme 2013). This soft approach to regulating disclosure has been interpreted in different ways, such as the "apply or explain" approach in South Africa's King Code of Corporate Governance, which states companies are responsible for interpreting the principles, and the stricter "comply or explain" principle in Denmark's Corporate Governance Code (Institute of Directors in Southern Africa 2016; van Wensen et al. 2011).

The intended audience for the sustainability disclosures is also discussed in existing studies. Under the "business case" approach, the primary goal of the sustainability report is to mitigate sustainability challenges faced by management, in order to provide useful data intended for investors, management and audit firms (Brown, de Jong and Levy 2009; Lozano 2013). This disclosure will then lead to maximization of shareholder returns (O'Dwyer 2002). This view mimics the investor-centric model of financial reporting (International Financial Reporting Standards 2014). The stakeholder accountability approach, on the other hand, supports the stand-alone sustainability reporting movement, by providing voluntary disclosures to audiences typically not reading the annual report and financial statements.

Lastly, the audit and verification process of sustainability reporting is often cited as a central component of the reporting practice (Coglianese 2012; Brown, Prieato and Tarca 2014). Current studies often assess if there is an external verification of the sustainability reporting, to what extent the report is verified, and if any possible sanctions come from this (Kolk 2008; Brown, Prieato and Tarca 2014). Professional services firms, certification bodies, consultants or government bodies may perform verification on the disclosures, however, professional services firms are the most common groups that perform audits of sustainability information (Kolk 2008). The role of institutions and legal settings in countries can impact the audit practice, as some countries have national audit standards (for example, Comité francais d'accréditation in France, AccountAbility 1000 Assurance Standard in the United Kingdom), while others do not.

These seven emergent themes from sustainability reporting policy literature provide an opportunity to look at how these approaches are employed by different countries. The TCFD looks at similar themes, including differentiating mandatory and voluntary disclosures and identifying reporting bodies and their respective audiences, the report format and specified materiality standards. However, the approach of this policy brief is distinctive, given its focus on national regimes, domestic policy features and emergent trends in sustainability reporting. This analysis allows for an assessment of the FSB TCFD's emerging approach to disclosure and, specifically, whether there is any alignment with existing domestic policies. This framework includes the format of disclosure, the scope of companies included, the report content, the existing legal or policy approach that is applied (for example, the "report or explain" principle), the intended audience of the report and the audit/verification practices that are in place.

National Diversity in Sustainability and Climate Change Risk Reporting

The following analysis will examine sustainability and climate change risk reporting in South Africa, France, the United Kingdom and Canada. This assessment can facilitate a "scanning of the environment" as a way to evaluate existing governance models (Adams and Whelan 2009).

South Africa

South Africa's unique social and political history has influenced the trajectory of its corporate reporting. In a post-apartheid society, South Africa wanted to emerge as a leader of the developing economies and promote international investment in the country. One way to establish a competitive advantage was by reassuring capital markets that South African companies were operating with due diligence and a strong governance framework. In 2010, the Johannesburg Stock Exchange (JSE) mandated listing requirements whereby companies had to adopt the King III Code of Governance. The King Code has served as an innovative, market-led initiative that forever changed the corporate reporting landscape.

The King Code is a set of corporate governance principles recommending companies adopt an integrated reporting format for corporate disclosures (see Institute of Directors in Southern Africa 2009). An integrated report includes both financial and non-financial disclosures, such as corporate strategy and governance structures, to understand how these mitigate risks and lead to short-, medium- and long-term value creation. One section of the King Code specifically calls for sustainability disclosures to be included in the integrated report. The code was implemented on an apply or explain basis, whereby responsibility was on companies (as opposed to the JSE or the government) to interpret and incorporate the governance code into their operations, and to provide a reasonable explanation if they chose not to apply it. The most recent draft version of the King Code (King IV) will follow the apply and explain principle, a more comprehensive adoption of the corporate governance principles (Institute of Directors in Southern Africa 2016). Now, each principle is to be connected to a corporate practice, as opposed to being omitted from the report.

France

The French approach to corporate reporting is quite different from South Africa's. France has a history of mandatory social reporting, and exists within the supranational European Union. France was one of the first countries to mandate sustainability reporting. In 2001, the country passed Les Nouvelles Régulations Économiques, whereby public companies were asked to disclose their social and environmental impacts in their annual reports. This led to a large uptake in environmental and social disclosures, and motivated a more detailed and expansive practice of sustainability reporting through the Grenelle laws of 2009 and 2010, in particular article 225. Rather than creating a new reporting format, the French government continued to mandate social and environmental disclosures in existing regulated financial reporting. However, the law also stated that public companies needed to connect their activities and commitments to sustainable development. These sustainability disclosures are typically found as a designated section in the "registration document"; this registration document is comparable to a lengthy, data-intensive annual report.

National lawmakers created the Grenelle laws, as opposed to a market-based or private standard setter, as seen in South Africa. The Grenelle laws present environmental, social and societal indicators to be adopted on a comply or explain basis. This means companies can omit information not relevant to their company, but must explain why. This explanation is then reviewed in the auditing of the registration document and the sustainability disclosures that are included. Despite a focus on compliance and verification, the enforcement mechanism for the Grenelle laws remains weak. The French government recognized that these disclosures are targeting investors and, as such, investors are to hold the company accountable to their social and environmental disclosures, or lack thereof. Under the concept of fiduciary duty, a concerned investor could then bring legal action against a French company. Thus, the enforcement mechanism remains on the individual investor, as opposed to the state.

The United Kingdom

The United Kingdom, similar to France, has a history of strong social disclosures in its corporate reporting, driven by union and labour movements in the 1980s. Moreover, the country itself has some of the most comprehensive voluntary sustainability reporting in the world (KPMG 2013). Aside from high levels of voluntary sustainability reporting, the United Kingdom regulates mandatory sustainability disclosures, specifically environmental ones, through the Companies Act of 2006. According to the act, listed and large non-listed companies must disclose key environmental performance indicators in their strategic report, a separate report from the financial statements.

UK companies are asked to disclose environmental, social, community and human rights policies, environmental and labour indicators in their strategic report (KPMG 2015). Given that these disclosures are found in a document targeted to investors, only material disclosures need to be included. Although policy transparency is considered a boilerplate disclosure, the United Kingdom is known for having strong labour, health and safety, and environmental legislation, whereby investors can hold companies accountable for absent disclosure or poor performance. Despite differences in the level of detail around environmental and social disclosures, both France and the United Kingdom offer strong regulatory frameworks from within the European Union.

Canada

The Canadian approach to corporate reporting is primarily built upon voluntary, stand-alone sustainability reporting. The Canadian economy is heavily dependent on natural resources, with resource industries issuing the first environmental reports in the 1990s. Canadian sustainability and financial reporting is quite similar to the United States and, unlike South Africa, France, and the United Kingdom, who have regulatory structures in place for sustainability reporting, Canada currently does not have mandatory sustainability reporting standards for public companies. There are some sector-specific regulations, such as required disclosures on community impact for financial institutions. There is also mandatory GHG reporting at the national level through the National Pollutant Release Inventory.

Much like the United Kingdom and France, environmental and social disclosures are only included in annual reports of Canadian companies if they are considered to be material to investors. Canadian sustainability reporting is thus substantially driven by voluntary initiatives. Companies are held to account for climate-related risks only insofar as they present a reasonable risk, or are identified as such by concerned investors. Guidance from securities agencies bears weight for public companies to consider. With provincial and territorial securities regulation, there is no national body to advise securities regulation, such as the Autorité des marchés financiers in France. However, a collective council of provincial and territorial securities regulators issued guidance stating that disclosure may be required concerning risk, environmental trends and uncertainties, environmental liabilities, asset retirement obligations, financial/operational impacts of environmental protection and risk management.

In reviewing and comparing these national approaches to sustainability reporting, certain trends are emerging in sustainability-related disclosure. These trends are largely motivated by uncertainty in capturing and communicating climate-related risks and sustainability information. The scope, verification, compliance principles, usage of materiality and target audience emerge as common themes in the identified countries. These emergent themes provide an opportunity to identify some recommendations for the current work by the TCFD.

Recommendations

Broaden the Scope of Disclosure to Include Corporate Sustainability

The scope of reporting at the domestic level is broader than with the TCFD report, and often includes other sources of financial information besides climate change risks. The TCFD (2016) states that climate-related disclosures should "incorporate the principle of materiality and would need to weigh the balance of costs and benefits." This objective for climate-related disclosures — to be able to provide sufficient information on financial risks to physical and financial assets, liabilities and future cash flows — is quite specific to translating sustainability risks into "dollars and cents." Meanwhile, although this objective is embedded in the domestic approaches discussed, countries with strong regulation — such as France and South Africa — require more than financial costs and benefits to be calculated. The Grenelle II law asks French companies for environmental, social and societal information in its call for recognizing sustainable development. The King Code asks South African companies to account for different types of capital, of which financial capital is only one. The TCFD should be aware of these broader conceptions of sustainability currently present in climate-related disclosures.

Adopt a Rigorous Disclosure Enforcement Mechanism

The apply/comply or explain model is the most common enforcement mechanism used by different governments in the study. The King Code's apply or explain approach demonstrates this, as companies are given discretion to interpret the code's guidance, as well as to explain how it impacts their long-term value creation. Compliance mechanisms such as the apply or explain approach, or the comply or explain approach in France, provide a middle ground between strictly mandatory regulation and voluntary guidance. The TCFD suggests using a voluntary framework, given the variety of legal institutions and market structures present at the state level. Insufficient enforcement represents one of the most significant weaknesses of sustainability and climate change risk disclosure because it limits comparability.

Investors and environmental groups both advocate for consistent disclosure as a means of improving financial decision making, in the case of the former, and of corporate accountability for sustainability in the case of the latter.

Materiality Needs to Reflect Challenges Involved in Measuring Climate Change and Sustainability Information

The use of materiality as a threshold for disclosure is adopted by some countries, but it is inconsistently applied. This confirms some research that contests the use of materiality as a means of standardizing climate change and sustainability disclosure. Corporate reporting practices for these metrics are still emerging and involve a great deal of subjectivity, which the TCFD recognizes. For this reason, initiatives such as the Sustainability Accounting Standards Board sector standards have included qualifications in the application of materiality by asking those that prepare reports to consider information on future risks (for example, physical risks from climate change) that may not be material on an annual basis, but could be in the medium term. The TCFD states that its recommendations "would need to incorporate the principle of materiality," which should be identified as financial risks that a company is facing (FSB 2016). The TCFD later defines materiality as information that "is highly relevant to an organization and is expected by key stakeholders as it may significantly affect their assessment of the organization" (ibid.). The TCFD notes that integrating climate change-related disclosures into financial reporting requires an "active" investor community that is engaged (i.e., proxy voting, shareholder resolutions put forward) rather than passive. The TFCD should be clear which groups' interests are to be included in materiality assessments of climate-related risks. Materiality could limit the availability of information that is needed to ensure that investors are engaged.

Conclusion

This brief provides a window into the domestic policy trends influencing sustainability and climate change reporting. Most research on sustainability reporting tends to focus on international or economic groupings. This is unfortunate as international financial reporting in other areas of practice, such as banking or accounting, often rely on and reflect domestic policy choices. A review of domestic approaches to the format of disclosure, the scope of companies included, the report content, the existing legal or policy approach that is applied (i.e., the comply or explain principle), the intended audience of the report, and the audit/verification practices in place supports several policy recommendations for the TFCD. More specifically, the TFCD should consider expanding the scope of disclosure beyond climate change to include corporate sustainability, should adopt a rigorous enforcement mechanism, and should assess how materiality can address the uncertainty involved in reporting on climate change and sustainability.

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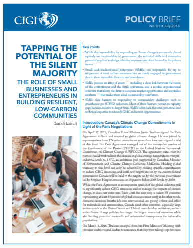

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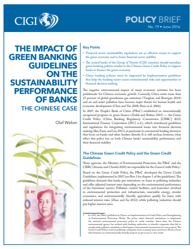

The Impact of Green Banking Guidelines on the Sustainability Performance of Banks: The Chinese Case

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Olaf Weber

The Green Credit Policy introduced guidelines and regulations for integrating environmental issues into financial decision making. The results of the analysis presented in the policy brief suggest that the environmental and social performance of Chinese banks improved significantly between 2009 and 2013 because the Green Credit Guidelines require banks to become active with regard to integrating environmental risks into their credit risk assessment procedures.

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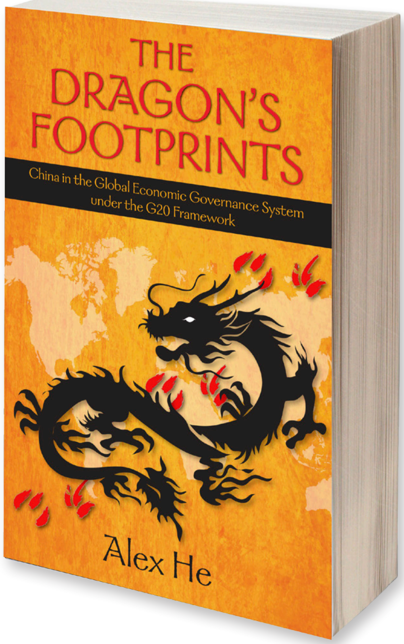

Coming Summer 2016

THE DRAGON'S FOOTPRINTS

China in the Global Economic Governance System under the G20 Framework

By Alex He

China's participation in the Washington G20 Summit in 2008 — under the shadow of the global financial crisis — marked the country's first substantial involvement in global economic governance. China played a significant role in global efforts to address the global financial crisis, emerging onto the centre stage of global financial governance, and has contributed to global macroeconomic policy coordination and global growth in the G20 ever since. China's hosting of the Hangzhou G20 Summit in 2016 provides a significant opportunity and platform for it to promote its ideas and priorities.

The Dragon's Footprints: China in the Global Financial System under the G20 Framework examines China's participation and roles in the major areas of global economic governance: the G20; the international monetary system, including the internationalization of the renminbi; global energy governance; global trade governance; and the global financial system, with a focus on its conduct in multilateral development banks, including the Asian Infrastructure Investment Bank and the New Development Bank.

There is no doubt that China has left its footprint on many aspects of the global international financial system. What has China's participation brought to global economic governance? And what has China gained or learned from its participation? *The Dragon's Footprints* answers these questions.

ISBN 978-1-928096-23-8
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Global Financial Governance Confronts the Rising Powers: Emerging Perspectives on the New G20

Edited by C. Randall Henning and Andrew Walter
Foreword by Barry Eichengreen and Miles Kahler

Emerging market and developing countries have doubled their share of world economic output over the last 20 years, while the share of the major developed countries has fallen below 50 percent and continues to decline. The new powers are not simply emerging; they have already emerged. This will remain true despite financial turmoil in some of the rising powers. This historic shift in the structure of the world economy affects the governance of international economic and financial institutions, the coordination of policy among member states and the stability of global financial markets. How exactly global governance responds to the rising powers — whether it accommodates or constrains them — is a leading question, perhaps *the* leading question, in the policy discourse on governance innovation and the study of international political economy.

Global Financial Governance Confronts the Rising Powers addresses the challenge that the rising powers pose for global governance, substantively and institutionally, in the domain of financial and macroeconomic cooperation. It examines the issues that are before the G20 that are of particular concern to these newly influential countries and how international financial institutions and financial standard-setting bodies have responded. With authors who are mainly from the large emerging market countries, the book presents rising power perspectives on financial policies and governance that should be of keen interest to advanced countries, established and evolving institutions, and the G20.

ISBN 978-1-928096-17-7
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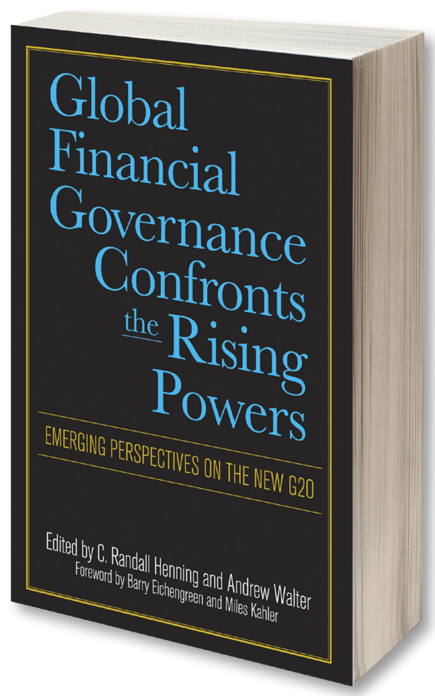

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Centre for International Governance Innovation

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About CIGI

The Centre for International Governance Innovation is an independent, non-partisan think tank on international governance. Led by experienced practitioners and distinguished academics, CIGI supports research, forms networks, advances policy debate and generates ideas for multilateral governance improvements. Conducting an active agenda of research, events and publications, CIGI's interdisciplinary work includes collaboration with policy, business and academic communities around the world.

CIGI's current research programs focus on three themes: the global economy; global security & politics; and international law.

CIGI was founded in 2001 by Jim Balsillie, then co-CEO of Research In Motion (BlackBerry), and collaborates with and gratefully acknowledges support from a number of strategic partners, in particular the Government of Canada and the Government of Ontario.

Le CIGI a été fondé en 2001 par Jim Balsillie, qui était alors co-chef de la direction de Research In Motion (BlackBerry). Il collabore avec de nombreux partenaires stratégiques et exprime sa reconnaissance du soutien reçu de ceux-ci, notamment de l'appui reçu du gouvernement du Canada et de celui du gouvernement de l'Ontario.

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