

18 December 2020

Dear IFRS Trustees

Re: The International Business of Federated Hermes' response to the IFRS Consultation on Sustainability Reporting

About the international business of Federated Hermes

Federated Hermes is a global leader in active, responsible investment. We are guided by the conviction that responsible investing is the best way to create long-term wealth. We provide specialised capabilities across equity, fixed income and private markets, in addition to multi-asset strategies and proven liquidity-management solutions. Through our world-leading stewardship services, we engage companies on strategic and sustainability concerns to promote investors' long-term performance and fiduciary interests. Our goals are to help individuals invest and retire better, to help clients achieve better risk-adjusted returns, and, where possible, to contribute to positive outcomes in the wider world. As of 30 September 2020, Federated Hermes had \$46.9bn assets under management.

Hermes Investment Management and Federated Investors rebranded as Federated Hermes in February 2020. All activities previously carried out by Hermes Investment Management now form the international business of Federated Hermes.

EOS at Federated Hermes ('EOS') is a leading stewardship service provider. Our engagement activities enable long-term institutional investors to be more active owners of their assets, through dialogue with companies on environmental, social and governance issues. We believe this is essential to build a global financial system that delivers improved long-term returns for investors, as well as better, more sustainable outcomes for society. EOS represents \$1213.1bn of assets under advice as of 30 September 2020. EOS conducts proactive and reactive engagement with the companies in which its clients invest on a regular basis on environmental, social, governance and strategy, risk & communications concerns. Our team engages in active stewardship on behalf of clients, voting at AGMs and other shareholder gatherings to achieve our clients' responsible ownership aims and fulfil their fiduciary duty to be active owners. EOS is a stewardship services provider and does not carry out regulated activity.

Our response to the specific questions raised is as follows.

Q1. 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?

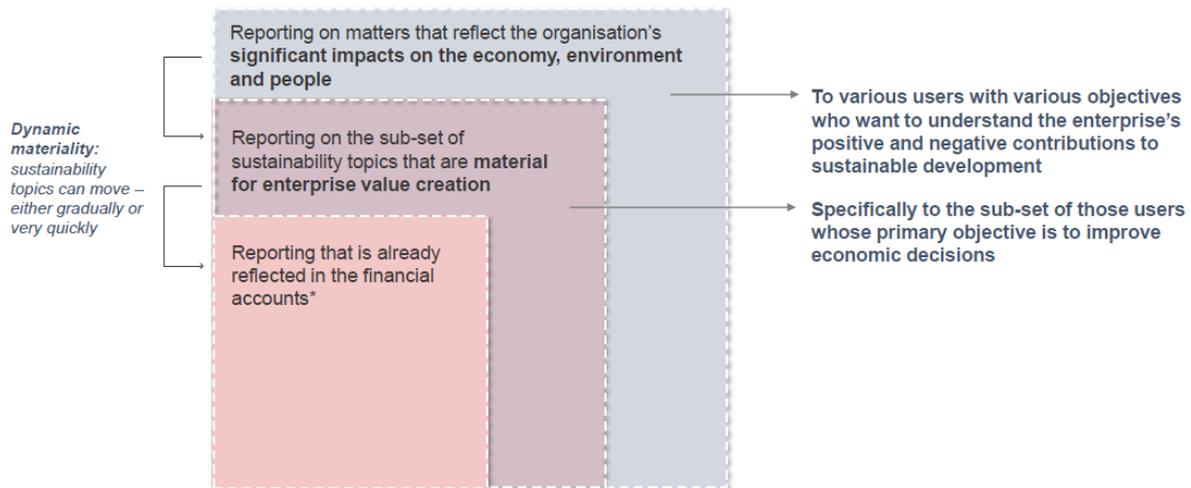
In an ideal world, yes there is a need for internationally recognised sustainability reporting standards. For existing preparers this would reduce the cost and complexity associated with current reporting requirements. For those new to sustainability reporting it would reduce barriers to reporting through removing the need to research which is the most appropriate regime or regimes to report against.

- (a) We are somewhat open on what role IFRS should play in this. While we welcome recent moves by the IFRS in formally recognising the need for climate change to be considered in financial reporting, it is focusing on the issue very late, does not have expertise in the area of sustainability reporting and does seem to have done a huge amount of research on the topic prior to issuing this consultation. The 5 existing framework/standard setters that IFRS mentions – SASB, GRI, CDP, CDSB and IIRC - have been looking at these issues for many years and bring with them a wealth of expertise and experience. We are heartened by their joint venture – even more so to hear about the merging of the IIRC and SASB. These two are a natural fit given IIRC’s focus on strategic issues and SASB’s more granular reporting focus. However, they probably don’t, even together, provide the full picture required for decision-useful disclosures: an explicit opportunity and risk focus in relation to climate change and wider sustainability issues still need to be reflected in disclosures.

We would prefer if these groups continue to self-organise a streamlined approach to consistent and coherent global sustainability reporting and for IFRS to engage closely with them to determine how this work can inform further adjustment to the interpretation or even amendment of IFRS financial reporting rules. In Figure 1 below (which is taken from the Joint Statement of Intent document¹), we see IFRS’s work as sitting in the pale pink box but feeding back into the purple box. In this way IFRS could build a bridge out from its financial accounting world to the sustainability reporting world and work out what and how to best integrate insights gleaned – which will likely focus on how sustainability considerations impact the financial value of firms as reflected in the accounts.

Figure 1. Statement of Intent to Work Together on Joint Corporate Reporting

¹ <https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work-Together-Towards-Comprehensive-Corporate-Reporting.pdf>



(b) We therefore suggest the IFRS first engage with this group of experts to understand how to work with them and further embed their expertise and insights into how current accounting rules are structured and interpreted. IFRS should also observe how the big 5 sustainability reporting standard setters' (now 4 since IIRC and SASB have merged) streamlining discussions are developing and engage with stakeholders to determine whether what is emerging is fit for purpose. If it is not, at that point the IFRS may be in a position to propose a further development of its institutional role. It is too early to jump to this conclusion now – and many reasons, as cited above, to be sceptical this is the right way forward.

Q2. 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?

While logically this approach makes sense, there are good reasons to think that the IFRS may not be the right 'home' for an SSB. We agree that IFRS has an excellent pedigree and the right networks for developing global reporting standards. We have concerns however over whether the organisation has the credibility to attract the right talent to be able to move forward with such an endeavour, especially given the efforts now being made across the big 4 standard setters to streamline advice to the preparers. We think it makes sense to explore a dialogue with these organisations on how best to cooperate/collaborate going forward, however.

Were the IFRS to play a role in developing global sustainability standards, with think this should - in an ideal world - be as an implementer of standards developed and agreed elsewhere by experts on the topic, i.e. IIRCC, SASB, GRI etc. This would make good use of IFRS's considerable expertise in implementation and dissemination of standards that can be applied and audited properly.

Q3. 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)?

Notwithstanding our earlier stated concerns, it is good that in thinking through this proposition the IFRS has come up with requirements for success. However, they seem rather loosely drafted and would benefit from more specificity and accountability around the timescales stated. The most important one is “achieving a sufficient level of global support from public authorities, global regulators and market stakeholders, including investors and preparers, in key markets”. Given the lack of expertise at the IFRS, this would need to include support from the existing global sustainability standard setters. If the consensus becomes that IFRS is to ‘set up’ in the space in some way it will likely need to recruit from these organisations: setting up a hostile situation between organisations will not be beneficial to achieving this.

Q4. 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?

Yes, we would imagine so. Our issues are not with IFRS’s networks, but with its expertise and legitimacy to move into the sustainability standards setting space. A robust collaboration with the global sustainability standard setters will be key.

Q5. How could the IFRS Foundation best build upon and work with the existing initiatives in sustainability reporting to achieve further global consistency?

IFRS should seek to collaborate with the existing initiatives in order to understand how their work can inform IFRS’s further adjustment to the interpretation or even amendment of IFRS financial reporting rules. This would build on the excellent recent initiatives around climate-related financial reporting, including the recent IASB paper, which makes clear that material climate change risks must be incorporated in IFRS financial reporting².

Q6. How could the IFRS Foundation best build upon and work with the existing jurisdictional initiatives to find a global solution for consistent sustainability reporting?

IFRS could play a vital convening role in this endeavour, working with the sustainability standard setters to engender a coherent approach over multiple jurisdictions.

Q7. 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?

Notwithstanding earlier concerns raised, yes climate change should be the immediate focus – both transition and physical risk and adaptation (one of the opportunity side of things).

² <https://cdn.ifrs.org/-/media/feature/news/2019/november/in-brief-climate-change-nick-anderson.pdf?la=en>

Q8. Should an SSB have a focused definition of climate-related risks or consider broader environmental factors?

Climate change is a complex systemic risk. It brings with it a range of environmental factors to consider, ranging from flood to water shortages, land loss to biodiversity loss, infrastructure destruction to health impacts. There is no quick answer – hence the need to consult and engage and determine what the current standards miss and how a value-add proposition could be facilitated by IFRS’s consultation. The opportunity side also needs to be considered – and is key to facilitating positive impact (which after all is what we all want) from reporting and engagement.

Q9. Do you agree with the proposed approach to materiality in paragraph 50 that could be taken by the SSB?

No. Double-materiality considerations are key to setting effective and meaningful strategy at the company level. This would be a backward not a forward step, given the leadership role played by the European Commission on this issue.

Q10. 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?

The audit industry is not yet skilled up to undertake the audits needed to prepare assurances, although we’d expect this to change over time. What will be most important to investors and other stakeholders is the transparency around assumptions and methodologies used in assessing risk and opportunity in relation to sustainability information.

Q11. Stakeholders are welcome to raise any other comment or relevant matters for our consideration.

While we have shared a figure in this consultation – under question 1 – to illustrate our points we would like to point out that we think issues put in the blue box should also be considered financial materially – the question is only over what exact timescale.

Yours faithfully,

Ingrid Holmes (Head of Policy & Advocacy)
Bruce Duguid (Head of Stewardship at EOS)