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Via email: commentletters@ifrs.org

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Subject: IFRS Foundation's Consultation Paper on Sustainability Reporting

On behalf of the California Public Employees' Retirement System (CalPERS), I write to express our views on the IFRS Foundation's (Foundation) Consultation Paper on Sustainability Reporting (Consultation).

CalPERS is the largest public defined benefit pension fund in the United States responsible for approximately $430 billion in global assets. CalPERS manages investment assets on behalf of more than 2.0 million members. As a global institutional investor with a long-term investment horizon, CalPERS relies on the integrity and efficiency of our financial markets to provide long-term sustainable, risk-adjusted returns. We are guided by the CalPERS Governance and Sustainability Principles[1] (Principles) which drive our engagement and advocacy efforts in our approach to governance issues that impact the integrity and efficiency of the capital markets. We expect fair, accurate, timely and assured reporting on how companies employ and identify risks related to financial, human, and physical capital to generate the sustainable returns we rely upon to pay our members' benefits.[2]

With regard to corporate reporting, Principles set out that "[c]ompanies should provide for the integrated representation of operational, financial, human capital management practices, environmental, social, and governance performance in terms of both financial and non-financial results in order to offer investors better information for assessing risk."[3] Furthermore, we identified improvements in data and corporate reporting as a priority in the CalPERS strategy for sustainable investment, adopted by our Board of Administration in 2016.

[1] See, CalPERS' Governance & Sustainability Principles, September 2019.
[2] Id. at 5.
[3] Id. at 27.

We applaud the Foundation for considering its role as a global standard setter for sustainability reporting, which could lead to establishing a Sustainability Standards Board (SSB) to produce global sustainability standards. CalPERS has long advocated for the integration of financial and sustainability reporting including requests to both the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) to enhance integration of sustainability issues in corporate reports. We have also-supported enhanced sustainability reporting in the Management Commentary by the IASB, and in Regulation S-K by the Securities and Exchange Commission (SEC) to achieve greater quality, consistency and comparability of sustainability information.

CalPERS believes that there is a need for a global set of internationally recognized sustainability reporting standards, and the Foundation is well suited to take on this challenge. The Foundation has our support to move forward with more detailed plans to establish a global model.

Although CalPERS supports global standards of reporting, we note that IFRS do not extend to the United States, the world's largest capital market. Hence, we see an opportunity for the SEC to work in parallel to the Foundation in order to galvanize work at FASB in relation to U.S. Generally Accepted Accounting Principles (GAAP) and corporate reporting more broadly. Such parallel work would integrate sustainability reporting into the regulatory provisions of the United States. Whilst we support global accounting and audit standards, with integration of relevant sustainability factors, we appreciate that IFRS and U.S. GAAP will continue on separate tracks and do not see a new SSB as having a mandate to override SEC provisions, but instead to coordinate and cooperate through established channels.

Question 1: Is there a need for a global set of internationally recognized 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?

Yes, notwithstanding the scope of IFRS, which does not extend to the United States, we see value in having internationally recognized sustainability reporting standards. Increasingly, market participants have been focusing on sustainability. Many initiatives have been created to address this desire for more comprehensive information. The result has been a proliferation of sustainable reporting advice which has created some challenges for both companies and investors. The adoption of internationally recognized sustainability standards will create clarity both for issuers and their investors. The Foundation has the mandate, the legitimacy and the experience with standards setting which is needed for the development of international sustainability standards for the primary users of accounts, namely investors. We see the vital importance of ensuring that investors are provided with both the qualitative and quantitative information needed to assess risk and return for both capital allocation and stewardship. The Foundation has our full support in taking on this work, which we see as an extension of current responsibilities to ensure corporate reporting is both true and fair.

We also accept that other stakeholders have an interest in wider reporting and CalPERS considers this to be important to our own fiduciary responsibilities given our status as a universal owner with intergenerational liabilities. An example is The Global Reporting Initiative (GRI) which has developed standards that are used by more than 10,000 organizations around the world and which they consider provide global standards for the benefit of stakeholders and are valued by investors. However, the Foundation in its proposal to establish an SSB is responding to a gap in relation to the particular needs of investors. Some sustainability reporting initiatives may need to evolve once the Foundation has built out its responsibilities in this arena. We see the potential for consolidation, which could build on recent initiatives to link the work of leading groups, which we welcome. We also see tremendous benefit for investors in developing standards which will allow comparison over time, and across sectors with the benefit of ensuring this reporting can be subject to internal control oversight by corporate audit committees and in turn by the auditor. This will drive tremendous improvement in both the quality and value of reporting. Given the scale and importance of the work to investors, there is a need to make certain that the Foundation pursues this work with the proper ambition.

The IFRS consultation also provides an opportunity to better understand who the primary users of corporate reporting might be at an organizational level. The financial markets include a wide range of investors with information needs that inform trading, capital allocation and stewardship, through engagement and proxy voting. Focus must be given on who the users will be within such organizations. Establishing a separate but connected SSB to cover sustainability reporting over the same footprint covered by the IASB involves greater ambition and involvement of a wider audience among investors than are typically engaged by the IASB which could be usefully expanded to include more substantial contacts with corporate governance and stewardship investment professionals. It will involve addressing both quantitative and qualitative issues while recognizing that materiality varies according to the user of the information. For a company, materiality is already defined by regulation. For investors, materiality can be broader, not just due to their portfolio wide holdings, but because their size and liability structure can lead to exposure to systemic risks. These can include externalities which are costs borne by wider society, but which for universal owners like CalPERS, can impact risk and return. This has been described as “double materiality.” Global investors are not only interested in impacts to companies which directly affect their portfolio, but they are interested in the wider impact companies may have on the environment and society as these externalities can lead to systemic risks. CalPERS, along with many other investors, who are broadly diversified, universal owners, is focused on the long-term, which includes addressing externalities and related issues not currently covered by traditional financial reporting. A clear example is climate change.

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?

We support the establishment of an SSB under the governance structure of the IFRS Foundation. This will allow for alignment with the core mission drawing upon particular areas of expertise. For that we encourage the Foundation to consider appointing leadership and staff for the SSB which reflect not only competence, but also diversity and focus on the investor agenda.

There is no question that the development of an SSB by the Foundation would produce greater consistency and comparability, but these should not be highlighted at the expense of transparency and quality.

Interestingly, there is a view that the large number of sustainability initiatives creates confusion, but the underlying reason for the initiatives happens to be poor disclosures on the part of companies. Various parties created initiatives to address this lack of transparency. These initiatives have differing levels of ambition. Sometimes this is revealed by where the information might be reported. If it is to be reported in the financials and audited, there is a need to make the disclosures tight and focused on the monetary components. As the reporting moves further away from financial reporting where the information is not subject to audit, initiatives are more ambitious regarding disclosure information. Setting the proper ambition and level of assurance will require a balancing act, but success in the sustainability space will require companies to be more transparent.

We would like to see greater transparency in both financial and non-financial reporting. This means that there is room for the disclosure of additional sustainability information in financial reports, along the lines articulated by Nick Anderson,[4] and there is a need, for more robust reporting of non-financial statement information. An example of non-financial information which is highly relevant to investors' management of risk is greenhouse gas emissions.

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)?

Paragraph 31 provides high level considerations, but in the absence of further details, at this stage, we are not able to provide additional input. For example, one could conclude that (g) will not be met if the IFRS Foundation pursues this seriously. There will be an impact on the current mission and resources of the Foundation if new resources are not mobilized including staff with the requisite expertise.

However, there may also be a need to revisit certain core elements of the IASB's work to facilitate the new work. For example, the IASB's existing definition of materiality appears to block consideration of information that is not in the financial statements per se. In late 2018, the IASB revised the definition of material to read as follows:

Information is material if omitting, misstating or **obscuring** *it* **could reasonably be expected** *to influence decisions that the primary users of general-purpose financial statements make on the basis of those financial statements which provide financial information about a specific reporting entity.*

[4] Nick Anderson, IFRS Standards and Disclosures (November 2019): https://cdn.ifrs.org/-/media/feature/news/2019/november/in-brief-climate-change-nick-anderson.pdf?la=en

Former IASB Board Member, Gary Kabureck, described the revised definition as narrowing "the audience for financial reporting."[5] With the creation of the SSB, there will be a need to expand the audience. There will need for the Foundation to change the IASB materiality definition to include the SSB, or for the Foundation to create a materiality definition for the SSB. We have always believed that higher level disclosure objectives should be pursued which will require a materiality definition that is more focused on what investors want.

With regard to achieving the proper level of technical expertise, it is clear that the Foundation will have to look beyond its existing experts. Chair of the IASB, Hans Hoogervorst, has stated: "I do not think the IASB is equipped to enter the field of sustainability reporting directly. Setting sustainability reporting standards requires expertise that we simply do not have."[6] It is very important that the Foundation bring on the right experts at all levels, including at the Foundation.

We favor developing synergies with financial statement reporting, but we do not want this to be a reason to water down the most ambitious initiatives meant to promote greater transparency and sustainability. Requirements for success should include developing quality standards that lead to greater transparency and support investors in achieving long term sustainable risk adjusted returns.

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?

Yes. The Foundation touches on most markets around the world, but it does not cover some key markets, notably the United States. Existing coverage enhances the probability that the Foundation will successfully be able to set sustainability standards given its existing contacts. The Foundation will have to expand its network, but it would be working from a strong starting point. It is important to engage organizations at a practitioner level for input on the sustainability standards. It is not enough to engage organizational leaders to get their buy in when they may have little experience with or knowledge of working with disclosure standards or on sustainability. The Foundation must develop productive relationships with initiatives focused on sustainability and with corporate governance and stewardship teams that have been focused on sustainable investment.

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

The Foundation must work with the existing initiatives if the standard setting is to be timely. It would take the Foundation significant time if it were to start from scratch rather than building on the work of other groups. The existing initiatives offer excellent starting points and are likely to have personnel with the required skill sets to produce sustainability standards. The various

[5] Gary Kabureck, IASB (28 January 2019) https://www.ifrs.org/news-and-events/2019/01/materiality-modernised/
[6] Hans Hoogervorst, IASB (2 April 2019): https://www.ifrs.org/news-and-events/2019/04/speech-iasb-chair-on-sustainability-reporting/

initiatives tend to independently determine their audiences and define what is material. They also have different levels of ambition in determining what companies should disclose. At the simplest level, some ask companies to disclose in one place certain information that they already disclose elsewhere. This constitutes a modest level of ambition because it provides no new information to the market. Others require tailored responses regarding narrow issues on items of importance to small constituencies. Such an approach is likely too specific for a global standard setter. There is a proper balance, but it should involve input from investors, including corporate governance and sustainable investment professionals.

The Foundation must clearly communicate what role it intends to play as early as possible. If it is only focused on sustainability reporting from the perspective of its existing audience, it would allow for certain initiatives to continue work as usual with knowledge that the Foundation will not provide an alternative to what they produce. In so doing, it will be less likely to disrupt the ongoing sustainability work by players focused on this segment.

We recently wrote in support of the Value Reporting Foundation (VRF) (which combines two organizations that we have supported, the International Integrated Reporting Council and the Sustainability Accounting Standards Board) in becoming a voluntary global sustainability standards setter during VRF's recent consultation. This endorsement is based on our knowledge of the good work completed by VRF and our assessment of what VRF might be able to accomplish in the future. We see VRF as part of the eventual solution to produce global sustainability standards, and its work would have greater traction embedded in an international standard setting organization with substantial regulatory authority.

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 expect that the Foundation would have a significant advantage in this area given its unique experience in working with the many jurisdictions on financial reporting. The Foundation is well suited to establish an effective communication network assisted by those sustainability initiatives that have their own outreach to build upon. The Foundation through its proposed SSB will have to engage collaboratively with jurisdiction-specific initiatives, especially those showing the greatest ambition. Sustainability reporting requirements set by individual countries or regions could draw from the SSB standards as good practice. Engaging with jurisdictional initiatives will enhance the work of the SSB and further the jurisdictional initiatives. Of importance is the European Union which has set out plans for the region, and by contrast, the United States which does not follow IFRS but where investors have been promoting new sustainability disclosures.

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?

No. If the IFRS Foundation establishes an SSB, it should focus on sustainability in a holistic approach. There are several reasons a climate-first policy is problematic. The first is that the other sustainability issues may be perceived as having less importance when in fact many issues are interconnected. CalPERS' Investment Beliefs recognize that long term value creation requires the effective management of three forms of capital: financial, physical and human. We appreciate that to report on one form of capital is limiting, but also an important dynamic is at work when the relationships between the three are considered. The current pandemic provides an example of urgency in reporting on human capital management, at the same time as climate risks are becoming acute and irreversible. It is likely that vaccines and other developments will make the pandemic less prominent in the coming years when the SSB begins its work, but the issues created by the pandemic have placed human capital and human rights at the forefront making it difficult for a global sustainability standard setter to ignore such issues at this time.

Furthermore, a climate first approach may block off the work of various initiatives that we expect would figure prominently in the proper development of sustainability standards. We think it is important to be able to call on full organizational buy-in from the existing initiatives which can only happen if the full range of issues are under consideration.

Finally, although climate-change disclosure is further developed in some respects because of initiatives such as the Taskforce on Climate-related Financial Disclosure, we see other important issues needing urgent attention, particularly in relation to human capital.

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

The SSB should consider all sustainability issues of importance to investors, so this means that all relevant environmental factors should be considered. There should not be a sole focus on climate-related risks. This approach would be too narrow. An example is the need to consider access to clean water, which is vital to human health and welfare, and related not only to climate change but other issues such as industrial contamination and overuse.

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

In order to properly answer the question, the Foundation should explain what it means by the term "investor." If it is focused on the analysts and portfolio managers allocating capital as well as the teams responsible for corporate governance and stewardship, then the initial approach may be fine. The answer is dependent on the level of ambition to produce more transparent reporting and thereby contribute to more sustainable global markets. Interestingly, the failure to focus on double-materiality would mean that overall sustainability standards may be weaker than they would have been had the Foundation remained with its current focus on traditional financial reporting In order to be transparent, the Foundation should state how its approach responds to investors' consideration of double materiality which actually involves more long-term and forward-looking considerations.

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?

Sustainability standards need to be designed to allow for assurance. Much of the information will not be auditable in the traditional sense just given the nature of some of the sustainability information, but it should be subject to some level of external assurance. Obtaining a high level of assurance will need to be resourced. However, this should not provide a reason for companies to resist such disclosure arguing that the cost of assurance outweighs the benefit, particularly when both those costs and benefits are borne ultimately by investors. On certain items, we would expect a reasonable level of assurance. On most items, limited assurance would be adequate. The SSB may benefit from work done by the International Federation of Accountants in its initiative on extended External Reporting which addresses the assurance of sustainability information. Getting audits or assurance should not be established as roadblocks to reduce ambitious disclosures but as enhancements to getting accurate information.

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

We value transparency and good governance in the development of an SSB. We want the SSB to be additive to the production of transparent sustainability information. We can only make well informed capital allocation and stewardship decisions if we have adequately robust, comprehensive and accurate information. Finally, we want to reiterate the importance of appointing both leaders and staff to the new SSB team who will bring not only competence, but diversity and investor focus.

We again applaud the Foundation for exploring the development of global sustainability standards. We look forward to providing support as the Foundation makes this important journey. Please contact Anne Simpson, Managing Investment Director, at Anne.Simpson@Calpers.ca.gov if you have any questions regarding our responses.

Sincerely,

Marcie Frost
Chief Executive Officer

cc: Anne Simpson