Research Platform
Sustainable Finance

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Closing the transparency gap: Germany's G7 presidency is an opportunity to promote sustainability reporting internationally

Katharina Erdmann, Ingmar Jürgens, Blerita Korca, Frank Schiemann, Theresa Spandel, and Raphael Tietmeyer

At a glance

- The German G7 presidency presents the opportunity to advance a central pillar of sustainable finance at the international level: mandatory disclosure of ESG risks and impacts.
- Without mandatory disclosure, it remains difficult for investors to shift capital toward more sustainable investments.
- More international alignment of disclosure regulation would facilitate the flow of sustainable finance across borders and greatly reduce compliance cost of financial and non-financial corporates.
- Germany could underline its claim to leadership in sustainable finance and contribute to setting ambitious international standards.
- This policy brief presents the seven key building blocks of effective ESG disclosure regulations, which is the relevant level of disaggregation for a meaningful discussion about international policy coherence.
- It provides specific recommendations and learning opportunities relevant for policy development and effective implementation (see Figure 1 on next page).
- All recommendations are based on a comprehensive analysis of ESG disclosure regulations implemented and planned in the member states of the International Platform on Sustainable Finance (IPSF), Brazil, and the US.

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At a glance *(figure)*

Figure 1: ESG Disclosure Building Blocks with Recommendations

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The ESG disclosure agenda for Germany's G7 presidency

Reliable environmental, social and governance (ESG[1]) disclosures help investors and analysts to identify and evaluate sustainable investments (Dhaliwal, Radhakrishnan, Tsang, & Yang, 2012), and to better assess their financial risks (Amel-Zadeh & Serafeim, 2018). Further stakeholder, including governments (Marquis and Qian, 2014) and consumers (Park, Lee, and Kim, 2014), also demand increased transparency to integrate reliable ESG information in their decision-making processes. Fostering ESG disclosures is thus a precondition to "shift the trillions", and the implementation of effective ESG disclosure regulations should be high on the political agenda. This holds particularly for Germany's G7 presidency. The programme for presidency explicitly mentions the improvement of transparency regarding sustainability- and climate-related aspects.[2] The preconditions to agree on and implement the critical next steps during the presidency are promising, given several coinciding events, such as the G20 presidency of Indonesia, a member of the International Platform on Sustainable Finance (IPSF), the EU presidency of France, which prioritizes the work on the Corporate Sustainability Reporting Directive (CSRD)[3], and the establishment of the International Sustainability Standards Board (ISSB) headquarter in Frankfurt am Main, Germany.

Utilizing this momentum is critical, as to date, the insufficiency of ESG data availability hinders investors to systematically consider ESG risks, opportunities and impacts in their investment decisions.[4] Even where data is available, investors often face difficulties to utilize that information due to a lack of comparability, relevance, and completeness[5]. To tackle these issues, authorities increasingly implement ESG disclosure regulations for corporates and financial products. The EU, for instance,

1 We use the term ESG throughout the report for consistency. We define ESG as a synonym for sustainability, and not as a narrower (shareholder-oriented) conceptualization of it.
2 Politische Schwerpunkte der deutschen G7-Präsidentschaft 2022 (available online, last access January 24, 2022).
3 Recovery, Strength and a Sense of Belonging. Programme for the French Presidency of the Council of the European Union (available online, last access December 22, 2021. This also applies to all other online sources of this report, unless stated otherwise).
4 CRed (2020): Hemmnisse der Integration von E(SG)-Daten in Investmentprozesse (available online)
5 IPSF (2020): Annual Report (available online)

passed the Sustainable Finance Disclosure Regulation (SFDR)[6] and recently proposed the CSRD[7]. To compare and understand the quality and effectiveness of such ESG disclosure regulations, it is helpful to differentiate between seven distinct, but interlinked ESG disclosure building blocks (see Figure 2).

The building blocks for effective ESG disclosure regulation

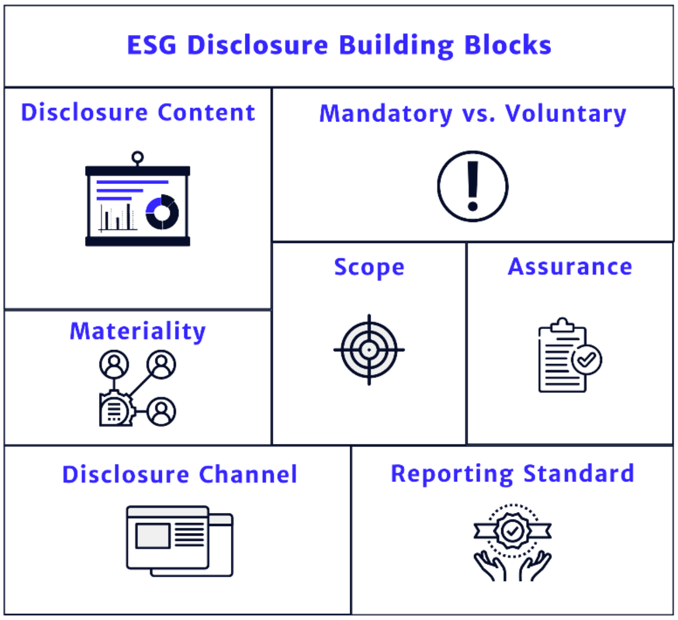


Figure 2: ESG Disclosure Building Blocks

In the following sections, we briefly introduce the building blocks and, on that basis, provide specific recommendations for Germany's G7 presidency and beyond. To contextualize our specific recommendations for each building block, we highlight the current state of regulation and offer learning opportunities for Germany and the EU. All recommendations are based on a comprehensive analysis of ESG disclosure regulations implemented in the member states of the IPSF[8], Brazil and the US. These discussions should be part of the agenda of the G7 finance ministers' meeting, but also the G20 Sustainable Finance Working Group, and the disclosure working group of the IPSF. Further background information on the building blocks

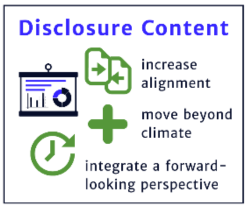
6 REGULATION (EU) 2019/2088 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 27 November 2019 on sustainability-related disclosures in the financial services sector (Text with EEA relevance) (available online)

7 PROPOSAL FOR A DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting (available online)

8 Argentina, Canada, Chile, China, European Union, Hong Kong SAR, India, Indonesia, Japan, Kenya, Malaysia, Morocco, New Zealand, Norway, Senegal, Singapore, Switzerland, United Kingdom

and the policy recommendation can be found an IPSF report written by the authors of this policy brief.[9]

1. Disclosure content



Disclosure content relates to the information which must be disclosed by entities. The content can target only one or several ESG pillars, can be qualitative and/or quantitative, and can consist of specific key performance indicators (KPIs) or generic information.

Disclosure content needs to be aligned

Current state: To date, the disclosure content widely differs throughout the world, which leads to a lack of comparability of companies' ESG disclosure. This is reflected, for example, in different KPIs and a large diversity in measurements. Especially the social pillar needs further development regarding the harmonization of relevant indicators, such as for human rights.

Recommendation: To improve the quality and comparability of disclosed ESG information, international co-operation and coordination are necessary.[10] Germany should take the initiative and strive for a further standardization of measuring methods and KPIs, possibly in line with the EU taxonomy.[11] We suggest concentrating on measurement examples and KPIs specifically for items, which are currently more difficult to disclose and measure (e.g., biodiversity, human rights, corruption), to create learning effects. To shape global standards, the EU should increase its co-operation with other large economies, such as the US, as well as with standard-setting institutions, such as GRI and ISSB.

9 IPSF (2021): State and trends of ESG disclosure policy measures across IPSF jurisdictions, Brazil, and the US (available online)

10 IPSF (2020): Annual Report (available online)

11 More information in PB 3/2021: EU-Taxonomie – Was ist das? (available online) and PB 4/2021: EU-Taxonomie – Was bringt sie? (available online)

The environmental pillar needs to go beyond climate

Current state: Regarding the environmental pillar, most regulations are unspecific or focus on the climate dimension only, whereas the disclosure of other crucial environmental challenges is underdeveloped.

Recommendation: We recommend the promotion of disclosure on all environmental dimensions, such as biodiversity and ecosystem services, water, pollution, as well as circular economy. The EU-Taxonomy is currently going beyond climate, covering a wider range of environmental issues and is therefore providing a good example for comprehensive environmental regulation. Following one of the input papers of the G20 Sustainable Finance Working Group[12], the importance of disclosing nature-related information is highlighted. In this regard, as a first step, Germany should join and financially support the Taskforce on Nature-related Financial Disclosure (TNFD), which aims to develop a disclosure standard considering all nature-related risks.

Integrate forward-looking and supply chain data

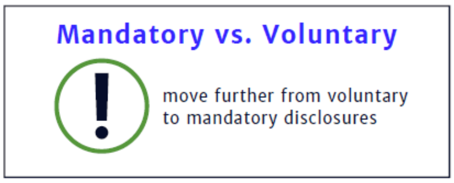
Current state: A comparable way of assessing and disclosing specific forward-looking information is still lacking. Yet, forward-looking disclosure is crucial as it allows disclosure to be more target-oriented and creates a pathway for ESG initiatives in the future (Agostini, Costa and Korca, 2021). For companies that are not "green" yet, it will be important to be able to demonstrate, based on transparent and standardised forward looking data, that they are committed to a timely transition. Further, only very few regulations require disclosure regarding ESG issues in firms' supply chains. However, supply chain disclosures covering all business activities are necessary to gain a complete understanding of a company's overall ESG performance.

Recommendation: Standards on the structure of reporting and broad reporting content guidelines need to be enriched with specific assessment and disclosure standards for forward-looking metrics. The CSRD refers to ESG targets while no further details about specific reporting requirements are provided yet. It is crucial that the European Commission advances the further development of the CSRD by offering clear guidelines on how disclosure on ESG targets should take place, and in

12 UNDP (2021): Reporting on nature-related risks, impacts and dependencies (available online)

how far their ex-post attainment should be made transparent, too. Germany should take such discussions to the international level in order to support internationally aligned, forward-looking disclosure. The lack of supply chain disclosures is another relevant aspect for consideration. Germany has recently passed the Act on Corporate Due Diligence Obligations in Supply Chains, which requires firms falling under the regulation to report on human rights and environmental issues within their own and their direct suppliers' operations. Germany should push for the inclusion of supply chain disclosures in upcoming EU reporting standards and regulations and promote effective disclosure requirements for the forthcoming EU supply chain law and beyond.

2. Mandatory vs. Voluntary



Guidelines, frameworks, or international standards represent voluntary ESG disclosure measures, while reporting regulations, laws, or reporting regimes represent legally binding, mandatory ESG disclosure measures. Entities might be subject to both mandatory and voluntary disclosure measures simultaneously.

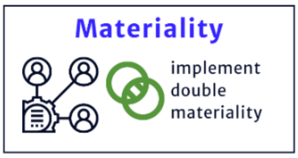
Move forward from voluntary reporting to mandatory reporting

Current state: Most jurisdictions have mandatory ESG disclosure regulation in place[13]. However, voluntary regulations still are also very common for certain information requirements.

Recommendation: Germany should strive to increase mandatory ESG disclosure regulations in the G7 and beyond to accommodate a similar level of disclosure as currently proposed with the CSRD. Learnings from the previously implemented Non-Financial Reporting Directive (NFRD) can give guidance, too.

13 IPSF (2021): ibid., p. 27

3. Materiality



The definition of ESG items' materiality determines how ESG issues are identified by regulators and reporting entities. Our policy brief 7/2021 [14] shows how materiality can be defined from an outside-in perspective (financial materiality), and from an inside-out perspective (stakeholder and comprehensive materiality). Double materiality combines both perspectives.

Implement double materiality

Current state: The IPSF-country analysis has shown that there is an increasing number of disclosure regulations with an underlying definition of materiality, currently targeted at financial materiality more often than double materiality. In Germany, entities will be subject to the progressive double materiality requirement of the CSRD. However, the CSRD still lacks guidance about which specific ESG issues are material for which companies or sectors.

Recommendation: Germany should consider facilitating the development at the G7 members from an outside-in perspective on materiality towards the use of double materiality, which also considers the inside-out perspective. Also, we suggest developing further clarifications on which specific ESG issues are material for which companies or sectors. While such clarifications are already available for financial materiality via SASB's materiality map[15] , guidance for the inside-out perspective is still lacking.

14 PB 7/ 2021: What information is relevant for sustainability reporting? The concept of materiality and the EU Corporate Sustainability Reporting Directive (available online). The outside-in perspective includes impacts that external factors make on a company and the inside-out perspectives the impact of a company for society and the environment.
15 See the website of the Sustainability Accounting Standards Board (SASB)

4. Scope

Scope defines which entities, financial products, or services are subject to ESG disclosure regulation. The definition of scope might be based on the legal status (e.g., listed companies), firm size, (environmental or social) impact, or sector affiliation

Expand the scope to more non-listed firms

Current state: Up to date, most ESG measures for non-financial corporates focus on listed firms. However, in some countries and sectors, a high share of carbon emissions comes from non-listed companies[16]. The proposal of the CSRD represents one of the first attempts to extend the scope to non-listed companies as it requires disclosure from large entities (even if not listed) and all listed entities (including small- and medium-sized enterprises, SMEs).

Recommendation: Germany should use its G7 presidency and sustainable finance discussions as an opportunity to foster international cooperation and alignment in expanding the scope of entities affected by ESG measures. A larger scope (including SMEs, based on the proportionality principle) for ESG disclosure would help not only

Learning opportunity: Some regulations implement an impact criterion for the scope on their disclosure measures. For example, in the US, the Greenhouse Gas Reporting Program (GHGRP)[1] is targeted at facilities with large Greenhouse Gas Emissions (GHG). Two other examples can be found in Japan: The Act on Promotion of Global Warming Countermeasures[2] mandates "specified emitters" to report their GHG, while the Act on the Rationalization of Energy Use[3] mandates companies using a lot of energy to report their energy consumption. Independent of disclosure regulations, the EU follows an impact-based approach for the selection of the participating installations of the emission trading system (EU ETS).

1 Compare information on the website of the US Environmental Protection Agency.
2 Compare information on the website of the Ministry of Environment
3 Compare information on the website of e-Gov Law Search

16 PB 8/2021: Why it would be important to expand the scope of the Corporate Sustainability Reporting Directive and make it work for SMEs (available online)

investors as users of ESG information but entities themselves to understand their impacts and improve accordingly. Furthermore, given the widespread demand of ESG-related information from banks, customers, suppliers, and rating agencies, a common set of agreed upon ESG disclosure items can potentially lower overall disclosure costs.

Require more financial product and service level disclosure regulations

Current state: Most regulations target the entity level, while too few regulations apply to the financial product and service level (e.g., bonds or equity funds). Further, the few regulations that exist on the financial product and service level mostly target only environmental disclosure, while ignoring governance or social disclosure, and only a few disclosure measures require specific content. Germany currently requires reporting based on one of the most developed regulations for financial products, namely the European Sustainable Finance Disclosure Regulation (SFDR).

Recommendation: The SFDR can set an example for other financial product regulations. Germany and the EU have the opportunity to promote their experience and the advantages of the SFDR and shape international standards.

Learning opportunity: Another opportunity to streamline reporting practices is to impose the same regulatory framework for entity and financial disclosure. The United Kingdom is currently planning a large program to mandate TCFD-based disclosures[1] for several capital market participants (e.g., listed issuers, private companies, asset managers, life insurers, pension providers) which would ease information processing for shareholders and stakeholders.

1 Compare information on the website of the Financial Conduct Authority

5. Assurance

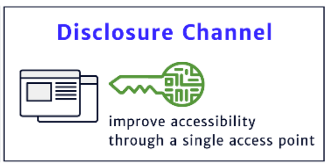
Assurance refers to the external verification of financial or ESG information of entities. Therefore, assured ESG information is perceived as more credible by users of sustainability reports (Quick and Inwinkl, 2020). Regulations can demand different levels of assurance requirements, ranging from "consistency checks" and "limited" assurance, to more thorough and demanding levels, such as "reasonable" or "full" assurance.

Including assurance requirements

Current state: Third-party assurance is rather scarce, but in a developing stage[17]. The current proposal of the CSRD requires sustainability reporting on the basis of a limited assurance engagement. However, the long-term objective is to have a similar level of assurance for financial and sustainability reporting[18].

Recommendation: Third-party assurance has to be considered with the notion of proportionality, as it can induce high costs for firms. Nonetheless, the enforcement of assurance is an important tool for credible ESG disclosure. Germany should set an example with suggesting limited assurance in the G7 member states but setting the long-term aim of having a similar level in ESG disclosure compared to financial disclosure on the agenda.

6. Disclosure channel



ESG disclosures can be published in different channels or mediums, e.g., as part of the annual report, in a separate sustainability report, or on a firms' website.

Single access points should make ESG data accessible

Current state: In all analyzed jurisdictions, there is at least one ESG disclosure regulation (planned or existing) that requires some public disclosure.[19] However, there are few which only require disclosure towards an authority.

17 IPSF (2021): ibid., p. 29
18 European Commission (2021): Corporate Sustainability Reporting Directive proposal (available online)
19 IPSF (2021): ibid., p. 30

Recommendation: To reduce information asymmetries, ESG information must be public and easily accessible. Germany should advocate for accordant regulations among other G7 members. In accordance with the recommendation of the G20 Sustainable Finance Roadmap to provide better public access to ESG data, Germany should promote a quick implementation of the European Single Access Point (ESAP), which will provide access to ESG information at firm level. The provision of the data by an independent, supranational organization could facilitate the access for professional and private users, as well as for researchers.

Learning opportunity: A current example for a database for (financial) disclosure represents the U.S. EDGAR Database[1]. The database contains registration statements, quarterly and annual reports and other forms which are mandatory to submit for foreign and domestic companies. The data is free, publicly available and accessible through a data API.

1 Compare information on the website of the U.S. Securities and Exchange Commission

7. Reporting standards

Reporting standards give guidance and orientation to entities on how to disclose ESG information. There is a range of available (international) reporting standards specifying disclosure content (e.g., methodologies, metrics and KPIs) and/or other building blocks for disclosure. However, a new disclosure regulation can also attempt to introduce a new reporting standard.

Sector-specific reporting standards

Current state: Regulations often refer to the GRI, SASB, the Integrated Reporting standard, or the recommendations of the TCFD. In the EU, following the NFRD, no clear guidance is given regarding the reporting standards (Korca and Costa, 2021). However, for the CSRD, the EFRAG is tasked to develop a new set of EU reporting standards.

Recommendation: Reporting standards are particularly helpful if they contain guidance about specific KPIs and metrics. Reporting standards with detailed guidance assist entities in reporting and increase comparability. Germany should advocate for a quick development of EU reporting standards which can be linked to existing international standards. Here, the IFRS foundation announced the establishment of the ISSB, which will also consolidate the Climate Disclosure Standards Board (CDSB) and the Value Reporting Foundation, which was just recently formed by the International Integrated Reporting Council (IIRC) and the SASB. Coordination and cooperation with the ISSB might be a central driver to foster international acceptance of a newly developed sustainability reporting standards, especially if existing differences (e.g., ISSB's focus on financial materiality vs. EU's focus on double materiality) can be resolved. Another important issue is the promotion of simplified reporting standards for SMEs, which is important to make the implementation of new disclosure standards feasible.

Learning opportunity: Different industries require distinct guidance. In the US, SASB specifies disclosures for financially material, investor specific ESG issues and respective accounting metrics and KPIs on an industry basis[1]. Their approach could be helpful to evaluate the respective developments and efforts of the EU taxonomy.

1 Compare information on the website of the Sustainability Accounting Standard Board

Conclusion

ESG disclosure represents a crucial element to enable sustainable finance. To increase it and thereby foster sustainable finance, the implementation and improvement of ESG disclosure regulation is a fundamental prerequisite. Additionally, standardization and harmonization are crucial next steps. The requirement to disclose in line with the EU taxonomy in the CSRD provides an example of how sustainable finance regulations can be linked. In this regard, Germany has the opportunity and responsibility to take sustainable finance discussions to the G7 presidency and to push for further ESG disclosure regulations. The coincidence of the German G7 presidency with the Indonesian G20 and the French EU presidency could be an opportunity to create broader backing for such an initiative. More specifically, the G7 finance ministers meeting, the G20 Sustainable Finance Working Group, and the disclosure working group of the IPSF can provide a forum for this. The establishment of the ISSB with its headquarters in Frankfurt further underscores the strong development towards sustainability reporting standards. Urgent action is needed to enhance corporate transparency about ESG impacts and risks by providing relevant and comparable information. To facilitate and foster discussions, we offer a set of recommendations which are summarized in Figure 1. The building block structure of this brief and the building block specific recommendations help to set a clear agenda. Therefore, it is crucial that Germany considers, discusses, and implements these recommendations for each building block of ESG disclosure.

Finally, we stress that while each building block's design is important for an effective regulation, the useful combination of the different building blocks is equally essential for an efficient ESG regulation. Our IPSF report (available online) provides a more detailed description and further policy examples for the key issues around ESG disclosure from across the world.

Katharina Erdmann is an Analyst at Climate & Company | Katharina@climcom.org

Ingmar Juergens is the Co-founder and CEO at Climate & Company | Ingmar@climcom.org

Blerita Korca is a Consultant at Climate & Company | Blerita@climcom.org

Frank Schiemann is a Professor of Accounting at the University of Hamburg | frank.schiemann@uni-hamburg.de

Theresa Spandel is a Research Associate at the Chair of Accounting at the University of Hamburg | theresa.spandel@uni-hamburg.de

Raphael Tietmeyer is a Research Associate at the Chair of Accounting at the University of Hamburg | raphael.tietmeyer@uni-hamburg.de

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About the project

The Sustainable Finance Research Platform is a joint project between five German research institutions conducting research on different aspects of sustainable finance, e.g., sustainable investments, sustainability risks and chances, and sustainability reporting. With their independent research, the project partners aim to support stakeholders in politics, the financial sector, and the real economy in understanding and shaping the central role of capital markets in achieving a net-zero economy. The researchers involved answer social, political, and business-related questions, provide established and new research findings, and participate in political and public debate. They also want to establish sustainable finance as a topic in the German research landscape and secure connections with international institutes and processes.

More information can be found on the project's website wpsf.de/en/.

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