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# The current state of sustainability reporting in financial services

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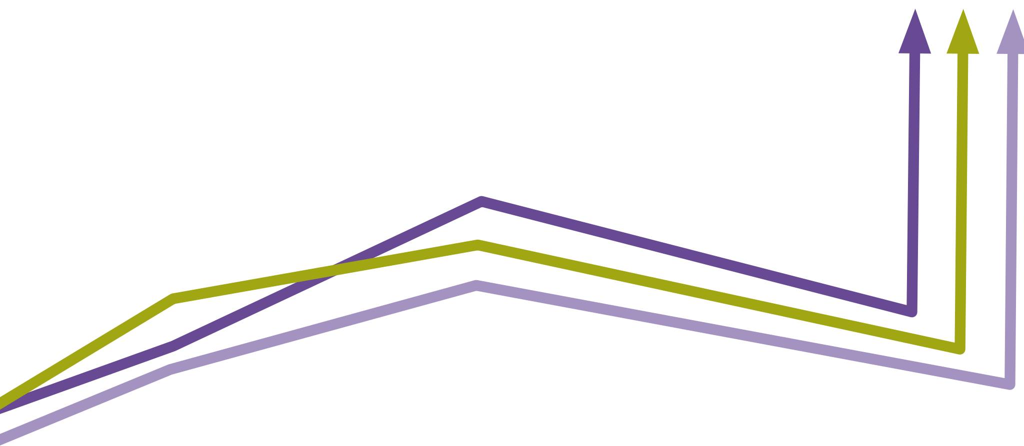
# SUSTAINABILITY REPORTING is on the RISE in the United States

Demand for sustainability reporting is on the rise in the financial services sector. For many bank stakeholders, an annual report confined to financial performance isn't enough. They want a document that examines the institution's long-term ability to pursue economic returns, while remaining ethically, socially and environmentally conscientious.

While sustainability reporting is still not as widespread in the United States as in some other countries, it is definitely on the uptick[1]. According to the Governance & Accountability Institute, nearly three-quarters of all of the companies in the S&P 500 Index and Fortune 500 are now publishing sustainability reports[2].

**Where is the demand coming from?**

1. Customers who are choosing sustainable products and services.
2. Retailers who believe sustainable goods are likely to sell better.
3. Investors allocating capital — not only managers of funds with dedicated green portfolios, but also those who believe companies that act responsibly provide better financial returns. These investors subscribe to this view, and there's evidence that companies committed to sustainability reporting can improve their operating effectiveness, cost structure and performance[3].
4. Graduating MBAs and college seniors — eager to join firms compatible with their personal values — who see firms that make sustainability a priority as forward-looking.
5. Media, activists, nongovernmental organizations (NGOs) and governments that seek to change the behavior of institutions and, in the process, often help shape their public image. For example, banks are under pressure from activists to release more information about the loans they make to firms that generate significant greenhouse gas (GHG) emissions[4].



[1] Baskin, Dorsey. "The current state of sustainability reporting," Grant Thornton, February 2014. See www.granthornton.com for more information.

[2] "Seventy-Two Percent (72%) of the S&P Index Published Corporate Sustainability Reports in 2013 - Dramatically Up from 52% in 2012 & Just About 20% in 2011," Governance & Accountability Institute News Center. See http://www.ga-institute.com for more information.

[3] Eccles, Robert G.; Ioannou, Ioannis; and Serafeim, George. "The Impact of Corporate Sustainability on Organizational Processes and Performance," Harvard Business School, July 29, 2013. See www.hbs.edu for more information.

[4] Ackerman, Andrew. "Banks Feel Heat on Climate-Change Issue," *Wall Street Journal*, Feb. 5, 2014. See online.wsj.com for more information.

## SEC guidance

Regulatory developments in the United States reflect the trend toward more corporate social responsibility disclosure, especially as it relates to matters that may affect investors.

In 2010, the SEC issued guidance related to the disclosure of climate change issues[5]. Stating that it took no position on "whether the world's climate is changing, at what pace it might be changing, or due to what causes," the commission outlined four areas where climate change issues may require disclosures:

1. Impact of legislation and regulation
2. Impact of international accords
3. Indirect consequences of regulation or business trends (for example, increased demand for goods that result in lower GHG emissions than competing products)
4. Physical impacts of climate change

Nevertheless, it doesn't appear the guidance has yet made a significant change in climate-related reporting in issuers' 10-Ks — particularly in the financial services sector. One study found that "real estate firms, insurance companies and banks were the least likely to disclose anything related to climate."[6] However, the SEC's action established the basis in securities regulation for disclosures beyond financial information that may materially affect investors and their decisions.

One specific area of social responsibility reporting has been mandated in U.S. securities law by the Dodd-Frank Wall Street Reform and Consumer Protection Act. The SEC issued a final rule in August 2012 that requires companies to disclose their use of so-called conflict minerals originating in the Democratic Republic of the Congo and adjoining countries beginning May 2014[7].

Despite the very limited regulatory mandates for sustainability reporting, some financial services organizations apparently do find benefit in reporting on sustainability matters outside of their regulatory reports.

## Reporting regimes

As companies decide what sustainability information to report and how, they encounter a variety of mechanisms, frameworks and content standards. Some are for specific areas of interest like the Carbon Disclosure Project for GHG emissions and industry-specific reporting standards issued by the Sustainability Accounting Standards Board (SASB). Others are broader regimes, with a more comprehensive, holistic approach, such as the new International Integrated Reporting Council's (IIRC) Integrated Reporting Framework and the well-established Global Reporting Initiative (GRI).

Happily, the single industry where both general-purpose and sector-specific reporting guidance can be found is financial services, but which bodies have produced specific guidance for financial services and how do the standards they have issued compare?

[5] SEC, Federal Register, Vol. 75, No. 25, *Commission Guidance Regarding Disclosure Related to Climate Change; Final Rule.* See www.sec.gov for more information.

[6] Eccles, Robert G., et al. "The Need for Sector-Specific Materiality and Sustainability Reporting Standards," *Journal of Applied Corporate Finance*, pp. 10-12, Spring 2012. See www.sasb.org for more information.

[7] Stippich, Warren, and Baskin, Dorsey, et al. "Efforts and consequences of conflict minerals rule," Grant Thornton, 2013. See www.grantthornton.com for more information.

## SASB

The Sustainability Accounting Standards Board (SASB) was founded in 2012 in San Francisco. Its supporters include Bloomberg LP and the Rockefeller Foundation[8].

### Standards structure

As explained in its proposed Conceptual Framework[9], the SASB has designed standards for the disclosure of sustainability issues that are material to investors in SEC documents (Forms 10-K and 20-F) prepared by publicly listed U.S. companies. Its intended end users are, therefore, primarily institutional and retail investors, not other stakeholders. The focus is Regulation S-K, which sets disclosure requirements for trends, demands and uncertainties in the management discussion and analysis section of Form 10-K. Despite the fact that the SASB has linked their disclosure recommendations to the SEC's reporting regulations, the SEC has not endorsed the SASB. In fact, one commissioner explicitly distanced the SEC from the SASB's recommendations[10]. At the same time, a recent former chairman of the SEC joined the board of the SASB in May 2014.

All told, the SASB plans to release standards for 88 industries in 10 sectors. Those for health care were issued for comment in July 2013; financial firms, February 2014; and technology and communications, April 2014. The standards are approved by the American National Standards Institute (ANSI) but have not been mandated by any regulatory body, including the SEC. There is an SASB Corporate Roundtable to support companies' use of its standards.

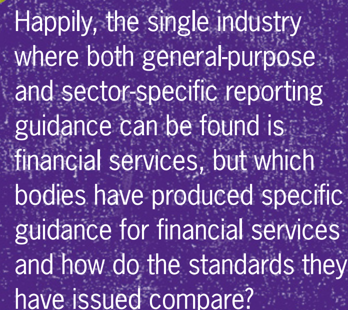
### Financial sector guidance

Making reference to its Conceptual Framework, the SASB published standards for seven separate financial services industry segments:

1. Commercial banks
2. Investment banking and brokerage
3. Asset management and custody activities
4. Consumer finance
5. Mortgage finance
6. Security and commodity exchanges
7. Insurance

Material sustainable topics are identified in each, with accompanying metrics designated as either quantitative or discussion and analysis. In commercial banks, for instance, the SASB has identified the following material topics (examples of metric(s) are below each topic):

- Financial inclusion and capacity building
  - Percentage of total domestic loans for underserved and underbanked business segments



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[8] "Bloomberg-Backed Group to Set Sustainability Standards," *Environmental Leader*, Oct. 9, 2012. See http://www.environmentalleader.com/ for more information.

[9] Conceptual Framework of the SASB, October 2013. See www.sasb.org for more information.

[10] SEC Commissioner Daniel M. Gallagher's Remarks at the 26th Annual Corporate Law Institute, Tulane University Law School, March 27, 2014. See www.sec.org for more information.

- Customer privacy and data security
  - Percentage of data security breaches involving customers' personally identifiable information
  - Discussion of management approach to identifying and addressing vulnerabilities and threats to data security
- Management of the legal and regulatory environment
  - Amount of legal and regulatory fines and settlements associated with financial industry regulation and percentage that resulted from whistle-blowing actions
- Systemic risk management
  - Results of Tier 1 capital stress tests
- Integration of environmental, social and corporate governance (ESG) risk factors in credit risk analysis
  - Discussion of credit risk to the loan portfolio presented by climate change, natural resource constraints, human rights concerns or other broad sustainability trends
  - Total loans made to energy/oil and gas, materials/basic materials, industrials and utilities industries

The guidance combines measures of economic viability (stress tests of regulatory capital) with more traditional environmental and social responsibility concerns (loans to underserved business segments).

Interestingly, the standards contain no specific metrics for reporting of carbon emissions or labor practices of the bank itself in carrying out its activities. This appears in keeping with the board's statement that in addressing sustainability issues like climate change, water use, human capital and political contributions, it does "not, as a matter of principle, systematically include certain sustainability issues in the disclosure standard for all industries."

## GRI

Founded in Boston in 1997, the Global Reporting Initiative (GRI) has its roots in the work of the Coalition for Environmentally Responsible Economies earlier in the decade. While information recommended by GRI may be included in financial reports and related disclosures, it is generally published in stand-alone annual sustainability reports.

### Standards structure

The GRI has developed a family of reporting guidance materials called the Sustainability Reporting Framework, – which includes the Reporting Guidelines, Sector Guidance (including for financial institutions) and other resources.

GRI guidance is designed for "sustainability reports by organizations, regardless of their size, sector or location," including multinational companies, but also smaller enterprises, public agencies, NGOs and trade associations[11]. Similarly, the intended audience is wide. Besides business and the investor community, it includes stakeholders from labor, civil society, accounting and academia. Thousands of companies worldwide produce annual GRI reports.

The guidelines include:

- **General Standards** that comprise strategy and analysis, organizational profile, identified material aspects and boundaries, stakeholder engagement, report profile, governance ethics and integrity.
- **Specific Standards** that provide detailed guidance in six categories — economic, environmental, labor practices and decent work, human rights, society and product responsibility — each of which is further broken down into four to 12 "aspects."

[11] See the Global Reporting Initiative *G4 Sustainability Reporting Guidelines FAQ* at www.globalreporting.org for more information.

The fourth generation of the guidelines (G4) was issued in May 2013, and reporting companies are now transitioning from G3 and G3.1 currently in use. Some notable changes:

- The guidelines are no longer structured into three-tiered application levels (C through A+) that require different amounts of detail. In G4, organizations report using either the core (less extensive) or comprehensive (more extensive) option.
- There's a new focus on materiality that encourages entities to report on issues most critical to it and its (many different types of) stakeholders.
- G3 reports that received some level of assurance by external parties would be so designated with a plus sign (+). This treatment was eliminated in G4. Instead, a reporting entity specifies which disclosures in its report have received assurance. As with G3, assurance is recommended, not required.

**Financial sector guidance**
GRI sector guidance supports, not replaces, the guidelines; indeed, it is deeply integrated with them and the accompanying implementation manual. The financial sector guidance was developed in 2008 under G3. It has been reformatted for use with G4 and is now called the Financial Services Sector Disclosures document; no content has been added[12].

The document describes four categories of financial institutions: retail banking, commercial and corporate banking, asset management and insurance. However, the guidance is written for the financial services sector as a whole, not for individual segments.

As with other GRI guidance, the document is highly detailed and specific. For example, environmental disclosures include the following:

"Financial institutions should estimate the GHG emissions resulting from their business travel because this represents one of the major direct impacts of financial institutions." This estimate should include:

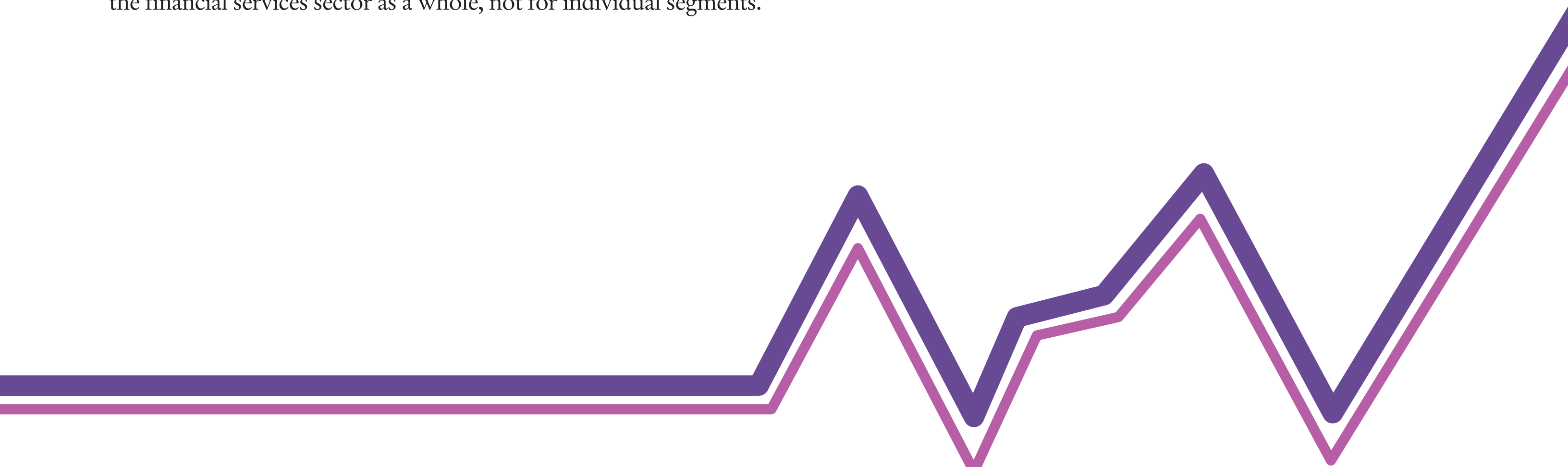
- Travel on behalf of the company or use of the company fleet
- The use of courier services[13]

From the labor practices and decent work subcategory:

"Financial institutions should report their policies and practices regarding threats and violence in place to assist workforce members, their families or community members, which might occur." Examples include:

- Attacks and aggressions by customers (verbal or physical) or others
- Bank robberies (e.g., kidnapping)
- As a result of legal reporting requirements on criminal activities (e.g., money laundering, terrorism)

"Policies and practices include education, training, counseling, prevention and risk control programs."[14]



[12] See the Global Reporting Initiative, *G4 Sector Disclosures*, at www.globalreporting.org for more information.

[13] *Ibid.*, p. 14.

[14] *Ibid.*, p. 16.

## SASB vs. GRI

Table 1 compares the two sets of standards. On the surface, the most notable distinction may be that the GRI is more detailed, particularly in its structure. But more fundamentally, as the table indicates, these are very different reporting regimes. SASB guidelines are meant for investors in U.S. publicly listed companies. They also are conceived entirely for investors, within the context of SEC reports (most notably Form 10-K and its Management Discussion and Analysis (MD&A). GRI guidance, in contrast, is intended for all stakeholders in public and private organizations worldwide. Its end product is commonly a stand-alone report.

**Table 1**
SASB vs. GRI

| | SASB | GRI |
|---|---|---|
| Established | 2012 | 1998 |
| Extent of adoption | First standards issued in 2013, so adoption still minimal | Well-established framework used by thousands of organizations |
| Primary reporting entities | Companies publicly traded in the United States | Global profit and nonprofit organizations |
| Intended audience | Investors | Numerous diverse stakeholders |
| Standards format and organization | Primarily industry-specific | Industry guidance supplements highly detailed general and specific standards |
| Reporting format | Included in MD&A in SEC filings | Stand-alone GRI report |
| Current status | Standards for three of 10 proposed industries have been issued | Transitioning from G3.1 to G4, which is required by year-end 2015 |
| Assurance needed | None | Recommended but not required |
| Materiality to users | Major focus | Greater emphasis in G4 |
| Specificity of financial services industry guidance | Specific to each segment, e.g., commercial banking within financial services | Applicable for industry as a whole, not each segment |
| Financial services guidelines | Issued February 2014 | Issued 2008 as part of G3; updated for use with G4 |
| Levels of application detail | One | Both core and comprehensive |

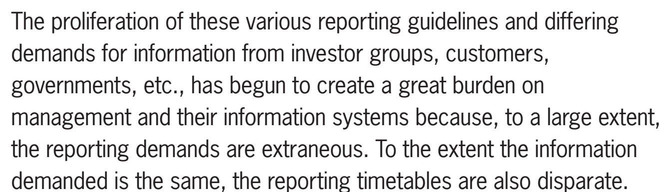
## Other reporting regimes

The SASB and GRI are not the only entities that have developed significant reporting frameworks and standards used for sustainability reporting, as shown in Table 2.

One trend that should be noted is the rising interest in integrated reporting, or IR, as promoted by the International Integrated Reporting Council (IIRC). Its International IR Framework, released in December 2013, states, "An integrated report is intended to be more than a summary of information in other communications (e.g., financial statements, a sustainability report, analyst calls, or on a website); rather, it makes explicit the connectivity of information to communicate how value is created over time."[15] IR dovetails nicely with AICPA's preferred definition of sustainability: the triple bottom line of economic viability, social responsibility and environmental responsibility — or the more catchy "profit, people, planet."

**Table 2**
Other reporting regimes

| Regime | Standards |
|---|---|
| IIRC | Published integrated reporting framework in 2013 |
| Carbon Disclosure Project | Supports a variety of programs for company reporting of GHG emissions |
| ISO 14000, 26000 | Standards for, respectively, environmental management and social responsibility |
| Dow Jones, Bloomberg, FTSE | Dow Jones Sustainability Indices, Bloomberg Sustainability Reporting Initiative, FTSE4Good Index Series |
| AccountAbility | AA1000 Standards |




[15] See the International Integrated Reporting Council's *International Framework* at www.theiirc.org for more information.

## Assurance services

The expansion in sustainability reporting over the past several years has been accompanied by increased demand for assurance services to ensure that the information is correct and complete. Assurance can be obtained on all information published or selected data within sustainability reports. Two levels of assurance reporting are available:

1. Review – limited assurance of the "nothing came to my attention" variety that is similar to a review of interim financial information
2. Examination – reasonable assurance comparable to that offered by a financial statement audit

The benefits of assurance are multifaceted and extensive:

- Signals to company staff that senior management is serious about measuring and reporting reliable information, engendering a higher level of compliance
- Generates independent insight into the design and operation of measurement and reporting systems, including consistency among divisions and geographies
- Produces recommendations for improvements
- Creates a higher degree of comfort at board and senior management levels that disclosures and talking points related to sustainability matters are correct and can be reliably cited in public forums
- Heightens the level of trust among stakeholders/users of the reported information

While the subject matter of sustainability reports is different than the focus of traditional financial statement audits, CPAs are well-equipped to be the preferred assurance providers. The processes and controls related to taking measurement and other sustainability data — compiling, summarizing and organizing it into useful reports — are firmly embedded in the prime expertise of CPAs engaged in assurance services. AICPA attestation standards are also directly applicable.

**Next steps**

The publication of the SASB's proposed standards and the release of the GRI's G4 guidance provide an excellent opportunity for financial services firms to evaluate their sustainability reporting programs and consider measures to improve them, including obtaining independent attestation reports. We recommend that businesses approach sustainability by focusing on three key strategic issues:

1. Visioning: Develop the core strategy for a sustainable business pathway
   - Establish executive leadership for the sustainability agenda
   - Understand the business model to support value creation
   - Assess what is truly material to your business and stakeholders that you wish and need to address
   - Establish goals and performance measures (metrics) for internal and external reporting
2. Embedding: Drive sustainability throughout operations and management systems
   - Integrate thinking so that both functional and operational teams buy into the program
   - Evaluate key resources and processes to understand how the organization utilizes financial, manufactured, human, natural and social capital
   - Build internal measurement and reporting capability
   - Manage with a sustainability dashboard
3. Reporting: Communicating goals and results successfully to all stakeholders
   - Develop external communications objectives and program
   - Obtain independent assurances on reported information

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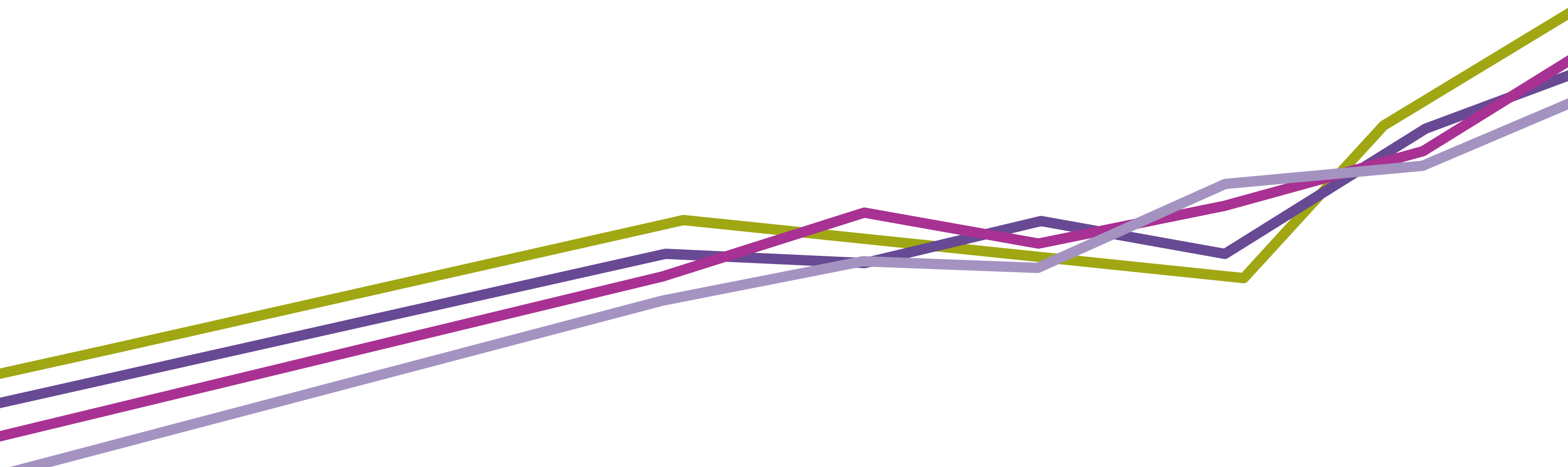

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