IFRS Foundation Columbus Building
7 Westferry Circus
Canary Wharf
London, E14 4HD
United Kingdom

30th of December 2020

Re: The European Leveraged Finance Association's Response to the IFRS Foundation's Consultation Paper on Sustainability Reporting

Dear Board Members and Staff,

Thank you for the opportunity to comment on your consultation exploring the potential role the IFRS Foundation could play in sustainability reporting. The European Leveraged Finance Association (ELFA) is a professional trade association comprised of European leveraged finance investors with more than 35 institutional fixed income managers, including investment advisors, insurance companies, and pension funds. The ELFA seeks to support the growth and resilience of the leveraged finance market while acting as the voice of its investor community by promoting transparency and facilitating engagement among European leveraged finance market participants.

On sustainability reporting, the ELFA is working to improve disclosure on Environmental, Social and Governance (ESG) topics in the leveraged finance market and to develop best practice guidance on ESG disclosures for sub-investment grade corporate borrowers. Our ESG Committee has launched several initiatives to the market to support greater disclosure. To foster development in this area, the ELFA and the Principles for Responsible Investment (PRI) have recently hosted two events during which investors conveyed to key market participants – including borrowers, bankers, lawyers, and private equity sponsors – the rationale for and importance of company disclosure of ESG information and data. Two key themes emerged from the discussion, and these are reflected in our response to your consultation: 1) investors are increasingly requesting ESG disclosure and data from borrowers; and 2) there is a need for a consistent ESG disclosure standard and a desire for the incorporation of such ESG information into primary deal documents.

As you are no doubt aware, the growth of ESG investment analysis in the leveraged finance markets is accelerating rapidly. Over the past few years, credit investors have widened and refocused their investment analysis to include more information on ESG topics. To this end, a rapidly expanding number of investors are requesting from borrowers ESG information that they consider material to their investment decisions, with many relying on proprietary questionnaires to gather this information. In fact, our investors report that ESG disclosure has gone from a nice-to-have to a need-to-have within the last 18 months. Overall, investors have become more vocal in encouraging companies to enhance their reporting on sustainability matters, and to align their disclosures with existing voluntary standards, and sub-investment grade corporate borrowers, in response, are quickly scaling up processes to collect and report ESG data.

This increasing demand for ESG disclosure in the leveraged finance market is propelled by three main factors which are examined thoroughly in our report "Why leveraged finance investors need more disclosure on ESG topics, and how this can be addressed". Firstly, there is mounting evidence that ESG analysis is additive to the investment process. Our investors strongly believe that there is an increasingly clear link between ESG factors and credit risk, and explained that ESG analysis has become integral to the investment process and central to the investment decision. In practice, company valuations can be significantly influenced by these factors, and better-quality disclosure and data allow for more accurate asset pricing and enhanced understanding of the drivers of risk and value in companies' business models. Secondly, there is an increasing demand by end investors for asset managers to demonstrate that they incorporate ESG considerations into investment products and processes. Senior fund managers reported that their biggest investors are increasingly requesting data to back the allocation of capital to ESG compliant investments. According to our investors, companies who fail to disclose ESG information appropriately risk exclusion from the investable universe. Indeed, appropriate disclosure on ESG can actually enable wider access to capital for borrowers. Finally, our investors cite the continuously emerging regulatory requirements that oblige asset managers (and borrowers) to disclose how they are managing the financial risks relating to sustainability, in particular the EU Sustainable Finance Disclosure Regulation (SFDR) and the EU Taxonomy Regulation.

Nevertheless, our investors are concerned that inconsistencies and variations in ESG-related disclosures have led to confusion and misunderstanding between investors and borrowers that may, over time, lead to erosion of trust in the industry and fuel greenwashing concerns. Unlike IFRS accounting standards, which provide global investors with mandatory, rigorous and comparable financial accounting information, there is no equivalent provision of sustainability information, which remains voluntary, of mixed quality and lacking in comparability. The substantial interest in, and resources and capital devoted to, investment products with ESG-related features have prompted a growing number of investment professionals and market participants to call for global convergence and a single framework that will bring consistency and comparability. The ELFA believes that the growing disparity between the increased demand by investors for ESG information and the existing level of disclosure inconsistency and confusion will likely lead to increased inefficiencies. Therefore, our investors are actively advocating for the adoption of global mandatory sustainability reporting standards that promote greater consistency and comparability and support comprehensive assurance.

Therefore, the ELFA supports the proposal to create a new Sustainability Standards Board (SSB) under the IFRS Foundation

We believe that the Sustainability Standards Board (SSB) is a necessary platform to build and coordinate a coherent global system for sustainability reporting. The IFRS Foundation is well placed, as an authoritative and experienced standard-setter, to leverage on the experience of the IASB to ensure the development of global sustainability reporting and help build the desired cohesion between financial and non-financial reporting. We also consider it appropriate for the SSB to operate under a parallel structure to the IASB. The three-tier governance structure has proven to be successful, and the IASB has a robust track record.

Our members agree with the widely held views communicated by other respondents that the SSB must accomplish the following to be efficient:

- Global mandatory standards: The SSB must help achieve global mandatory standards for use by global investors and companies. This is to ensure that global investors have access to comparable information across their portfolios, and that companies have access to data for peer benchmarking and internal decision making. To achieve this, the SSB must have well established relationships with governments, regulators and key market authorities across different jurisdictions.
- Market Legitimacy: Sustainability disclosure standards must have the same market legitimacy as financial accounting standards. In this respect, we emphasise that the SSB must have the perquisite credibility and accountability, which require robust governance and independent oversight, including a dynamic due process focused on transparency and broad consultation with all the relevant stakeholders.
- Technical Expertise: The SSB must have highly respected standard-setting expertise to develop sustainability disclosure standards and measurement criteria, which require a broader experience and knowledge set than that used for financial accounting standards development.
- Cohesion with IFRS financial reporting: Finally, the SSB must establish an adequate framework to connect and integrate sustainability and financial reporting standards, including retaining a traditional approach to materiality that provides investors with information relevant to investment decisions. Hans Hoogervorst, Chairman of the IASB, explained that the "potential interplay of IFRS requirements with sustainability issues is quite far reaching"[1], and this was further emphasised in Nick Anderson's 2019 article "IFRS Standards and climate-related disclosures".

[1]Hans Hoogervorst's keynote address at the IFRS Foundation virtual conference, reported in <https://www.accountancydaily.co/ifrs-foundation-look-sustainability-reporting>

The ELFA recommends that the SSB adopts and implements the existing standards on an interim basis, through a comply or explain procedure, and seeks to establish a framework and ongoing process to develop and maintain those standards

We believe that the SSB should leverage the existing sustainability disclosure standards and frameworks. Our investors are apprehensive about the prospect of yet another sustainability standard, for fear of increasing the confusion in the market and slowing down the momentum of the existing efforts. Instead, our investors would urge the IFRS Foundation to function as a unifying force, bringing the existing voluntary frameworks and standards together under the umbrella of the SSB in order to create a single foundation for sustainability reporting.

Indeed, there is already strong momentum towards convergence between the key voluntary sustainability standard-setters and frameworks. In the Statement of Intent to Work Together Towards Comprehensive Corporate Reporting, the Group of Five outlined a shared vision that includes both financial accounting and sustainability disclosure, connected via integrated reporting. The Group illustrated how the combination of existing standards and frameworks can effectively address market uncertainties and deliver high-quality, consistent, comparable, and verifiable sustainability disclosure. In fact, the Group extended an invitation to the IFRS Foundation and IOSCO to join the collaboration.

Additionally, the IIRC and SASB announced their intention to merge and create a Value Reporting Foundation. The merger advances the proposals in the Statement of Intent, and directly responds to calls from global investors and corporates to simplify the corporate reporting landscape. The Value Reporting Foundation will merge the SASB and IIRC into a credible, international organisation that maintains the Integrated Reporting Framework, advocates integrated thinking, and sets sustainability disclosure standards for enterprise value creation. The Value Reporting Foundation could eventually integrate other entities focused on enterprise value creation, and the CDSB has signalled interest in entering into exploratory discussions in the coming months.

Therefore, we believe that the IFRS Foundation could make a much more valuable contribution to the current status quo by adopting, on an interim basis, those standards and frameworks as building blocks. To this end, we suggest that the SSB review and develop an understanding of the existing standards, and identify the most suitable standards to adopt on an interim basis. We agree with other market suggestions that companies should be required to use the adopted standards on a comply or explain basis. We would suggest that the SSB then establish a conceptual framework and due process to maintain and develop those standards on an ongoing basis. Finally, it is crucial that any amendments to the current standards should only take place through global coordination and consultation.

We are available to discuss these comments and suggestions with you at your convenience.

Kind regards,

Sabrina Fox
Executive Adviser
European Leveraged Finance Association (ELFA)
sfox@elfainvestors.com
+44 (0) 7921 384 457
www.elfainvestors.com