Sustainability reporting in Asia

Are the EU's initiatives the benchmark for ESG disclosure in the region?

mazars

東京工業大学
Tokyo Institute of Technology

Preface

Corporate sustainability reporting is a dynamic space where Europe appears to have taken a lead even though many countries, including in Asia, are also progressing in this strategically important area that impacts corporate valuations, supply chains, and business models. However, a lack of convergence of regulatory frameworks in Europe and Asia risks hampering objectives of transparency, reporting quality, comparability, as well as investment and trade.

Multiple national and international ESG reporting frameworks exist. The 'equivalence' or 'convergence' of these different frameworks is top of the agenda for many regulators, as they look to address concerns over the global competitiveness of local companies, and manage the burden of overlapping and overly complex requirements for internationally active companies. The comparability of reporting frameworks provides additional reassurance to investors, regulators, and other stakeholders, as it enables them to make decisions based on the best available and most accurate data.

Over the past two decades, the EU has aimed to position itself as a global frontrunner in ESG reporting, with regulations becoming ever more stringent and, more recently, with the introduction of mandatory reporting.

The first mandatory non-financial reporting framework, the Non-financial Reporting Directive (NFRD), came into force in 2017. This is now being succeeded by a set of three legislative texts that will substantially increase the data and information companies and financial institutions have to provide on their sustainability risks and impacts. These are the Corporate Sustainability Reporting Directive (CSRD), the Sustainable Finance Disclosure Regulation (SFDR), and the so-called EU Taxonomy of environmentally sustainable economic activities.

These three pieces of regulation represent a massive shift in how economic and financial stakeholders need to evaluate sustainability risks and impacts and in what ways they need to collect and disclose any related data. Although these regulatory developments are being driven by the EU, their impact will be global as they not only create reporting requirements for international subsidiaries of EU groups, but also will drive how EU groups organise their supply chains on a global basis.

In parallel, Asian and other jurisdictions have been developing their own ESG reporting frameworks and regulations. To reduce the reporting burden for globally active companies, the CSRD provides for an equivalence regime that will allow for substituted compliance under certain non-EU disclosure regimes. For example, under certain conditions, non-EU parent undertakings may report on a consolidated basis for their EU subsidiaries, provided that the consolidated sustainability reporting of the non-EU parent undertaking is prepared in an equivalent manner to the EU standards. However, at present, it is unclear whether substituted compliance will be available to Asian companies and their EU subsidiaries, given potential divergences between local disclosure standards.

This report aims to provide a better understanding of the EU's sustainability reporting landscape and how it compares to four key Asian jurisdictions: Japan, Korea, Thailand, and Singapore. While these four Asian jurisdictions are certainly not representative of the entire continent, they face many of the same challenges that other Asian jurisdictions, including India, China, and Indonesia, are exposed to.

We hope it helps regulators, business leaders, investors, and other interested stakeholders to gain a better insight into the EU experience, providing insights and ideas to inform their own sustainability strategies and practices, and broadening the discussion about the path to equivalence or convergence of standards.

Emmanuel Thierry
Partner, Audit & Assurance – Sustainability, Mazars

Dr Kim Schumacher
School of Environment and Society at Tokyo Institute of Technology, School of Geography and the Environment at University of Oxford

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In order to direct capital towards sustainable projects, activities, or assets (PAAs), it is paramount to first obtain a proper understanding of the sustainability risks and impacts of key economic stakeholders, most notably large, corporate entities and financial institutions. The primary instruments to achieve this conditional level of transparency are sustainability reporting and ESG (environmental, social, and governance) disclosures. Similar to the financial reporting that listed companies are legally mandated to provide at regular intervals, sustainability reporting covers the non-financial risks and impacts of a business' PAAs. A variety of organisations and initiatives have existed in the space of sustainability reporting for more than two decades, the first landmark constituting the creation of the Global Reporting Initiative (GRI) in 1997 in Amsterdam, Netherlands. In the following years, various actors have started to work towards a common goal of improving the availability of sustainability performance, risk and impact data across businesses and global supply chains. Highlights comprise the years 2000 and 2015, marked respectively by the founding of the Carbon Disclosure Project (CDP) and the establishment of the Taskforce on Climate-related Financial Disclosure (TCFD).

While all of these prior efforts were strictly voluntary in nature and were mostly driven by shifting consumer awareness around sustainability topics, an increasing number of law- and decision-makers, including investors, have recognised sustainability risks and impacts as material factors that will influence future business growth and stability. Therefore, several governments have started to aim at improving overall ESG disclosure by gradually implementing or developing plans to mandate at least some minimum levels of sustainability reporting within their jurisdictions. The most advanced and prominent plans in this are currently moving ahead in the EU, where the first mandatory, legal, non-financial reporting framework, the Non-financial Reporting Directive (NFRD), which entered into force in 2017, is now being succeeded by a set of three legislative texts that will substantially increase the data and information companies, and financial institutions have provided in terms of sustainability risks and impacts. This trifecta is composed of the Corporate Sustainability Reporting Directive (CSRD), the Sustainable Finance Disclosure Regulation (SFDR), and the EU Classification System establishing a list of environmentally sustainable economic activities (EU Taxonomy), which will all have entered into force by the end of 2022.

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These pieces of EU legislation and regulation represent a massive shift in how economic and financial stakeholders need to evaluate sustainability risks and impacts and in what ways they need to collect and disclose any related material data. While these initiatives were subject to considerable debate and negotiations across a large spectrum of affected or interested stakeholders, their advanced and mandatory nature also renders them potential templates for other non-EU jurisdictions that seek to advance sustainability reporting among their corporate and financial actors. This report should be regarded as guidance for Asian stakeholders, particularly law- and decision-makers, business leaders and investment practitioners, to better understand the EU's sustainability reporting landscape and how it compares to those in selected Asian jurisdictions, namely, Japan, Korea, Thailand, and Singapore. While these four Asian jurisdictions are certainly not representative of the entire continent, collectively, they face several of the same challenges to which a many other Asian jurisdictions, including India, China, and Indonesia, are exposed.

This report is structured around four key pillars, which enhance a broader understanding of the obstacles and opportunities of the various sustainability reporting approaches in the EU and Asia:

1. An overview of the sustainability reporting landscapes in the EU and Asia and how recent developments are shaping the availability of quality corporate ESG data.
2. Contextual insights and perspectives from EU-based and Asia-based experts that underpin the challenges among Asian regulatory, corporate, and financial stakeholders to craft adequate responses that balance the sustainability data expectations of international investors and the often-complex domestic economic realities.
3. A mapping of sustainability reporting frameworks, discussing the stringency levels of the main reporting obligations across jurisdictions, thus enabling the establishment of a comparative reporting benchmark that will facilitate the identification of the current levels of ambition across the covered jurisdictions.
4. An evaluation of the transposability potential of the EU's sustainability reporting initiatives by exploring the case of how the EU's shifting approaches and recent adjustments towards double materiality and the establishment of a common taxonomy for green activities have gradually led to differing levels of acceptance for its plans among Asian law- and policymakers.

Sustainability reporting in Asia
Key takeaways

Ten key takeaways for Asian law- and policymakers, as well as business leaders, in anticipation of changing global sustainability reporting landscapes that increasingly take account of shifting ESG transition risks and opportunities:

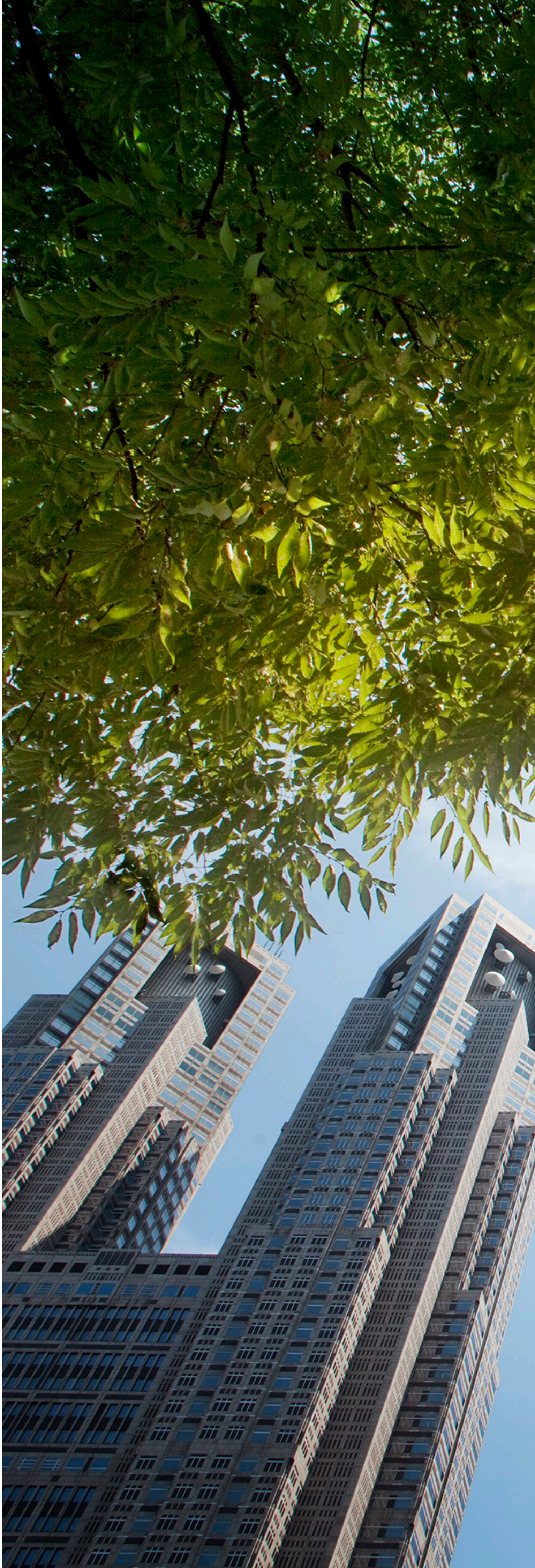
1. Sustainability reporting stringency is accelerating globally, including within the EU and across Asia, both in terms of stakeholder scope and materiality considerations.

2. The EU's existing and planned frameworks represent the current global benchmark in sustainability reporting stringency given the focus on mandatory rules and the gradually broadening scope of stakeholders covered under them, having started with large, listed companies and now including all listed companies (and considering EU-based SMEs), EU and non-EU financial service providers, and soon even non-EU companies who are part of EU-based companies' supply chains.

3. The main mandatory actions are being driven by lawmakers, regulators, and stock exchanges. The most advanced proposals originate from the EU, with plans announced by the US SEC (Securities and Exchange Commission) being fairly advanced as well.

4. Asia is generally less developed in terms of sustainability reporting-related laws, rules, or regulations of mandatory nature. The majority of efforts are driven by financial regulators in coordination with local stock exchanges.

5. Thailand and Singapore require sustainability reporting on a 'comply or explain' basis for the time being. Japan is planning to introduce mandatory sustainability reporting for large listed companies between FY2022 and FY2023. South Korea is maintaining voluntary ESG disclosure at least until 2025.



Key takeaways

6. There is a noticeable divide in the areas and topics that companies will need to cover in their sustainability reporting, with the EU opting for a GRI GSSB-inspired multi-stakeholder approach rooted in the 'double materiality' concept[1]. However, all of the observed Asian jurisdictions opted for investor-orientated 'single materiality[2]', mostly in line with the concepts forwarded by the IFRS' (International Financial Reporting Standards') ISSB (International Sustainability Standards Board) and the TCFD.

7. Whereas the EU, and the US SEC, require independent assurance of reported sustainability information, first limited and then reasonable, the observed Asian jurisdictions do not mandate external third-party verification, with only Singapore and Japan recommending it.

8. There are substantial economic risks for globally operating Asia-based companies and suppliers in case of sustainability reporting-related regulatory divergence and subsequent non-compliance with EU laws, rules, and regulations. On the other hand, EU-based companies could potentially face either competitive advantages as being more ESG-aligned than their peers, or competitive disadvantages, primarily due to increased costs associated with increasing corporate reporting requirements.

9. The EU's rules are seen as too rigid in most Asian jurisdictions as they either do not sufficiently take into account the significant natural resource and fossil fuel exposures of local economies or the emerging economy status of many Asian countries. In terms of sustainability reporting, the key provision facing pushback is the double materiality approach of the EU, which numerous Asia-based industry groups and regulators consider challenging to integrate in the near term. Asian jurisdictions generally favour a financial materiality-orientated global baseline for sustainability reporting, closely aligned with the TCFD recommendations.

10. One of the most substantial challenges for international corporations and regulators concerns the transposability of sustainability reporting-related rules. For example, the CSRD's new provision states that EU-based subsidiaries or branches of third country undertakings (i.e. non-EU companies) will also have to produce sustainability reports if they generate a net turnover of more than EUR 150 million in the Union. However, this requirement does not affect third country undertakings from jurisdictions with sustainability reporting standards considered equivalent to the EU's. This constitutes a very material example of how the EU's sustainability reporting plans will impact sustainability reporting in Asia and the potential risks of regulatory divergence.

    While the CSRD plans might create new obligations for Asia-based corporations, many of the EU's sustainability reporting-related plans actually overlap with many Asian framework plans and thus present potential pathways of how to increase transposability and reduce regulatory divergence. The EU Taxonomy could serve as a template, more specifically the additional Taxonomy delegated act published in March 2022, which allows certain activities related to gas and nuclear to be considered as contributory to sustainability goals. While highly controversial and contested by many ESG stakeholders, including its own expert advisory body, it resulted in aligning the EU, intentionally or inadvertently, to a higher degree with the various 'transition taxonomies' of several Asian jurisdictions, including Japan, Korea, and ASEAN.

1. Double materiality (a.k.a impact materiality or societal materiality) is defined as: Companies have to report about how sustainability issues affect their business and about their own impact on society, including people and the environment.
2. Single materiality (a.k.a financial materiality or enterprise materiality) is defined as: Companies have to report how sustainability issues affect their business activities, asset-level risk exposure and enterprise value.

Contacts

Emmanuel Thierry
Partner, Audit & Assurance – Sustainability, Mazars
emmanuel.thierry@mazars.fr

Dr Kim Schumacher
School of Environment and Society at Tokyo Institute of Technology, School of Geography and the Environment at University of Oxford
schumacher.k.aa@m.titech.ac.jp

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