Syntax

Breaking Down the Basics: ESG Reporting Standards vs. Frameworks

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Introduction

Given the constantly evolving nature of ESG investing, Syntax believes gaining clarity is of the utmost importance to the growing number of investors in this space. Consequently, we are focused on educating investors on ESG topics and using our proprietary data to provide unparalleled transparency on the ESG characteristics of their portfolios. In this installment of our "Breaking Down the Basics" series, we explore the topic of ESG reporting standards and frameworks.

It has become a trite phrase by now: the alphabet soup of ESG. This term describes the proliferation of ESG frameworks and standards (and their respective acronyms) that have cropped up in recent years. In this piece, we will provide a high-level overview of the most widely adopted frameworks and standards to help investors understand which frameworks might best suit their goals.

ESG Reporting Standards

An ESG standard is a set of criteria that identifies a company's alignment or adherence to certain ESG topics. Normally, ESG standards are expressed by a refined list of material topics and metrics, such as greenhouse gas emissions, water use or data security. An ESG standard provides companies and investors with a shared language through which to identify, assess and manage ESG risks.

International Financial Reporting Standards (IFRS) Sustainability Disclosure Standards

The International Sustainability Standards Board (ISSB) was created in 2021 by the IFRS to construct a globally harmonized ESG disclosure standard. A single global reporting standard has been a long-time goal of the ESG community, and it appears that the IFRS Sustainability Disclosure Standards is poised to become just that. It is suggested that a commencement date for voluntary company reporting should start on January 1, 2024.

ISSB's predecessor, the Sustainability Accounting Standards Board (SASB), also governed by IFRS, is still used broadly by companies and the investment community. The ISSB plans to integrate SASB's industry standards with its future IFRS Sustainability Disclosure Standards.

SASB criteria is focused on industry-specific materiality based on 77 industries

Who should use this standard?

• Asset Managers, Public Companies and Private Companies

What kinds of investors should use SASB?

• Investors who want to take a financial materiality approach to ESG investing. SASB is a building block for companies that want to simplify their ESG reporting based on industry materiality. For example, iron and steel producers have a number of material ESG topics, including but not limited to greenhouse gas emissions and employee health and safety. Asset managers might utilize SASB to evaluate companies' ESG risks during the due diligence process, whereas public/private companies may leverage SASB to inform.

Global Reporting Initiative (GRI)

The GRI was established in 1997, following the Exxon Valdez oil spill and established the early groundwork for ESG reporting, launching the first version of its guidelines in 2000. Considered the founding global standard for sustainability reporting, GRI focuses on a variety of stakeholders, ranging from investors and customers to employees and communities. GRI breaks down sustainability reporting through three standards, including Universal, Sector and Topic Standards. The Universal Standard applies to all companies, capturing logistical information such as the requirements and principles of the GRI Standard, alongside reporting requirements on material topics. Sector Standards are currently only applicable to the following industries: Oil and Gas, Coal, Agriculture, Aquaculture and Fishing, which are considered the most environmentally impactful. Topic Standards are identified by an individual company based on its internal materiality assessment. In the ESG universe, GRI will remain pertinent and complement the future development of the IFRS's Sustainability Disclosure Standards.

GRI criteria is focused on universal, sector and topic standards

Who should use this standard?

• Asset Managers, Public Companies and Private Companies

What kinds of investors should use GRI?

• Investors seeking detailed reporting standards for companies that want to take a broader stakeholder view of ESG, not one solely based on financial materiality. The GRI standards might not be the best guide for broad-based investors given that it relies heavily on a company-reported materiality assessment. In essence, the GRI standard serves as a tool for investors seeking out companies that abide by it as a way of validating the company against one of the most well-respected ESG standards.

Science-Based Targets Initiative (SBTi)

As companies continue to make commitments towards net-zero carbon emissions goal, the SBTi aims to galvanize the private sector to take action on climate change and is an exceptional instrument for companies that want to merge both climate science and effective investment decision-making to ensure alignment with the Paris Agreement.[1] By using science-based targets, companies can better understand how much and how quickly they need to decarbonize to avoid the consequences of global warming. The science-based targets vary by industry and aid companies in quantifying their resource use with an eye towards the carrying capacity of both local and global ecosystems.

SBTi criteria is focused on target boundary, greenhouse gases (GHG) coverage and scope coverage

The process for a company to comply with SBTi is:

1. Commit: Submit a letter establishing its intent to submit a science-based target

2. Develop: Work on an emissions reduction target in line with its SBTi's criteria

3. Submit: Present a target to the SBTi for a complete validation

4. Communicate: Announce its target and inform its stakeholders 5. Disclose: Report company-wide emissions and track target progress annually Who should use this standard? • Asset Managers, Public Companies (subsidiaries should roll up to the parent-level reporting), Private Companies and Financial Institutions

What kinds of investors should use SBTi? • SBTi is a useful framework for any investor looking to align with net-zero targets of the Paris Agreement. Additionally, any investors hoping to produce a robust analysis of their portfolio's carbon emissions, including scenario analyses, might consider using SBTi as a benchmark.

Helpful Resources:

How to set a science-based target: https://sciencebasedtargets.org/resources/files/SBTi-How-To-Guide.pdf

Net-zero standards criteria: https://sciencebasedtargets.org/resources/files/Net-Zero-StandardCriteria.pdf

ESG Reporting Frameworks

An ESG framework is a more malleable, path-driven approach without widely specific definitions for communicating a company's alignment when compared to the standards above. Think of a framework as a winding road with many avenues for getting to a predetermined destination. By leveraging the lenient structure that ESG frameworks offer, a company is able to roadmap, communicate and disclose how it is managing its ESG risks and opportunities.

The Task Force for Climate-Related Financial Disclosures (TCFD)

Every business across the globe is subject to some degree of climate risk. In 2015, the G20 Finance Ministers and Central Bank Governors asked the Financial Stability Board to review how the financial sector can account climate issues, and as a result, the TCFD was created as a firstof-its-kind framework that enables companies of all sizes to disclose and assess climate risks and opportunities.

TCFD criteria is focused on climate-related risk and opportunity

The process for a company to comply with TCFD is having these in place:

1. Governance

2. Strategy

3. Risk Management

4. Metrics and Targets

Who should use this standard?

- Asset Managers, Public Companies and Private Companies

What kinds of investors should use TCFD?

• The SEC's proposed climate-related disclosures rule is looking to the TCFD as the architecture for reporting on climate risks and opportunities.[2] Additionally, the IFRS Climate-Related Disclosure Standards will also adopt the recommendations set out by the TCFD.[3] Given that future regulations are likely to incorporate TCFD in some way, it would be prudent for all kinds of investors, even those not explicitly focused on ESG, to take steps to measure their portfolios against the TCFD.

United Nations Principles of Responsible Investment (UN PRI)

Established in 2005, the UN PRI is a network of more than 7,000 signatories from 135 countries that provides guidance to asset managers and financial service providers on how to incorporate responsible investing into both the investment decision making process and general firm strategy. Upon becoming a UN PRI signatory, firms are required to submit an annual report disclosing the ways they incorporate responsible investing across the firm, from asset selection and risk management to stewardship, engagement and client reporting. Across these categories, the UN PRI scores firms across the set criteria. UN PRI reports are used across the investment industry in the manager and service provider due diligence process.

Who should use this framework?

• Asset Managers, Service Providers

What kinds of investors should use the UN PRI?

• Firms looking to attract ESG-focused institutional clients should consider becoming a UN PRI signatory. UN PRI is a strong antigreenwashing tool that many clients seriously consider during firm due diligence. As responsible investing criteria becomes increasingly encoded in global regulatory statutes, it might no longer be sufficient to merely fulfill the minimum requirements of the UN PRI. Instead, clients and prospective clients may put more emphasis on a firm's performance according to the scoring rubric.

Looking Forward: Emerging ESG Regulations

In many ways, the above frameworks and standards are precursors to regulatory bodies formally encoding ESG requirements into law. The European Union, with its Sustainable Financial Disclosure Regulations, is leading the way. In the United States, it is highly anticipated that the SEC will be releasing the final version of its landmark climate disclosure for public companies by April 2023. The proposed rule will mandate public companies to publicly report on their greenhouse gas emissions, along with disclosing potential climate risks relating to potential impact on company operations or financials. However, it is unlikely these formal regulations will entirely usurp the frameworks and standards that have been outlined in this paper. It is more likely that they will work in harmony to further develop and streamline the ESG reporting ecosystem.

As seen by regulatory agencies in other regions such as Asia, Thailand's Securities and Exchange Commission, Malaysia's Joint Capital Committee on Climate Change and Hong Kong's Securities and Futures Commission all support or take into account the TCFD recommendations as part of their ESG reporting criteria. Additionally, in China, albeit a lack of mandatory ESG reporting for companies, China's Enterprise Reform and Development Society (a think-tank backed by the Assets Supervision & Administration Commission) has developed ESG reporting guidelines with a focus on usual suspects, such as scenario analysis and environmental impacts.

As a whole, investors will greatly benefit from increased streamlining, consistency and transparency in regulatory expectations. Effective regulation will take into account both company and investor needs and mitigate greenwashing. Waiting for the regulatory bodies, however, is not recommended. By all accounts, regulatory bodies will use the above frameworks and standards as baselines when developing rules. By setting up processes now to adhere to any of the above frameworks or standards, investors can be well-positioned to comply with regulatory requirements quickly and seamlessly.

At Syntax, we want to provide investors clarity and transparency around every aspect of ESG investing. To find out how the Syntax Affinity Platform, our data tools and custom investment solutions can help your organization meet its ESG goals, connect with us at contact@syntaxindices.com.

[1] The Paris Agreement is a legally binding international treaty adopted by 196 parties in 2015 at the UN Climate Change Conference (COP21). The Paris Agreement is intended to prevent the "increase in global average temperature to well below 2 degrees Celsius above pre-industrial levels" and limit "the temperature increase to 1.5 degrees Celsius above pre-industrial levels."

[2] https://www.sec.gov/news/press-release/2022-46

[3] https://www.ifrs.org/content/dam/ifrs/project/climate-related-disclosures/issb-exposure-draft2022-2-climate-related-disclosures.pdf

About Syntax

Syntax LLC is a financial data and technology company that codifies business models into a relational system we call Affinity Data™. Syntax operates through three segments: Affinity Data™, Syntax Direct™, and Syntax Indices™. Using its patented FIS® technology inspired by systems sciences, the Affinity Data™ segment offers the most comprehensive, granular, and accurate product line revenue data available on the market. The Syntax Direct™ segment then uses this abundance of data to facilitate the near instantaneous creation and ongoing management of boundless direct indexing solutions and rules-based equity portfolios through a fully automated platform. The Syntax Indices™ segment offers customized and proprietary indices, including core global benchmarks and micro- and macro-thematic, smart beta, defined outcome, and target volatility indices. These indices are foundational for a range of financial products, such as ETFs, UITs, and structured products.

All Syntax products were developed in conjunction with a patented information system for classifying and organizing business, financial and economic activity called the Functional Information System (FIS). FIS provides the technology used to identify business risk across companies, sectors, and time.

Important Information