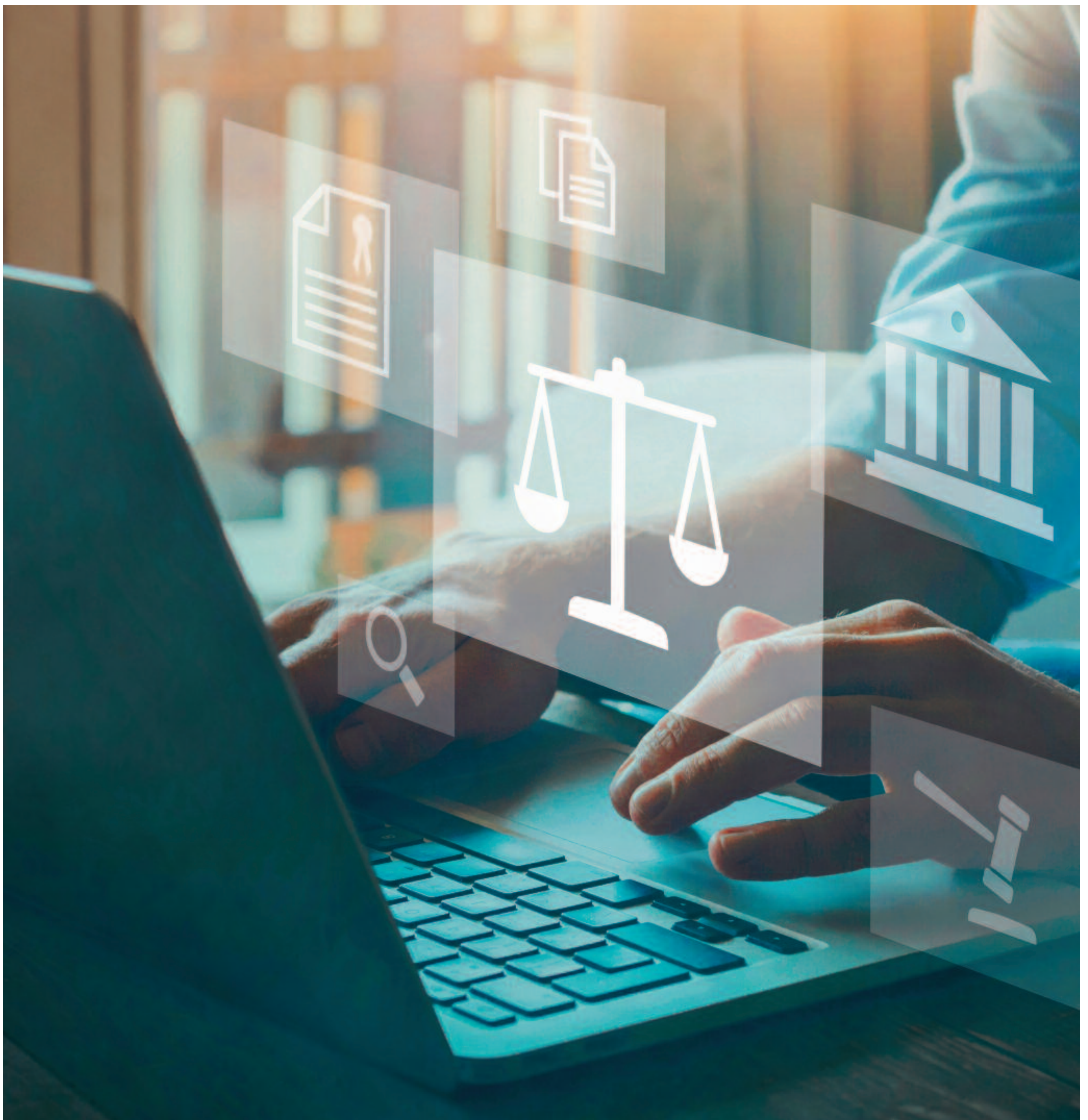
Regulatory context: characteristics, trends and applicability

"This is why the implementation of the European Pillar of Social Rights is so important - to ensure decent jobs, fairer working conditions, better healthcare and better balance in people's lives"

– Ursula von der Leyen[16]



Considering the significance associated with environmental, economic and social challenges, international institutions, regulators and supervisors around the world have begun to promote regulatory development in this regard, establishing guidelines and facilitating the transition to a more sustainable economy.

Among the international initiatives with the greatest impact and global reach, two fundamental agreements that set the priorities for sustainability at the global level are worth highlighting: the Sustainable Development Goals (SDGs)[17] and the Paris Agreement[18]:

- The 2030 Agenda on Sustainable Development, agreed in September 2015 at the United Nations Assembly, involved the adoption by world leaders of a set of global goals to eradicate poverty, protect the planet and promote prosperity for all. The novelty of this framework is its multidisciplinary nature, both in the use of sources and in terms of the stakeholders involved. This has led to a deep sense of adherence and to its implementation throughout the international community, from stakeholders in the public sphere (multilateral organizations, institutions and states) to those in the private sphere (companies, tertiary and quaternary industries, foundations, civil society, etc.).

- On the other hand, the signing of the Paris Agreement reached at the United Nations Framework Convention on Climate Change in 2016 marked the recognition of the climate change challenge and the need to move towards a carbon neutral economy2 as a global priority. The signatories to the agreement committed to "keeping the global average temperature increase well below 2°C above pre-industrial levels and pursue efforts to limit that temperature increase to 1.5°C."

To date, environmental risk, and in particular climate change mitigation and adaptation, have been at the forefront of regulatory developments due to the perceived urgency and magnitude of the challenge posed by this phenomenon. To this end, a multitude of commitments and national Climate Change Framework Laws have proliferated[19]as well as the establishment of carbon pricing and greenhouse gas emissions markets[20].

However, it is also observed that regulations are tending to adopt an integrated approach to sustainability, considering the environmental, social and corporate governance (ESG) pillars, promoting positive impacts and mitigating and managing negative impacts.

In short, the main objective is the gradual integration of these factors into economic and business decision-making at all levels. To this end, the regulations focus on the following aspects:

- Integration of ESG criteria and risks in the strategy, governance, management and decision making and internal processes of organizations, both in their current situation and in their objectives and future plans[21].

[16]Ursula Von der Leyen (2021). President of the European Commission at the 2021 State of the Union address.
[17]United Nations (2015).
[18]Paris Agreement (2015).
[19]Some relevant examples of this trend, among many others, are the European Climate Law, the Draft Law of the Spanish Congress of Deputies, approved in Congress on April 8, 2021 ; Chile's Draft Framework Law on Climate Change in 2019 ; the New Zealand Government's Climate Change Response (Zero Carbon) Amendment Act 2019 (or the French Draft Law (2021) (), . The first climate law adopted in the world was that of the United Kingdom in 2008
[20]Carbon Pricing Leadership Coalition (2021).
[21]Some relevant examples of this trend are the ECB Guide on Climate Risks (2020) or Asobancaria's General Implementation Guide in Latin America.

- Promoting sustainability disclosure across all economic sectors, including transparency on ESG risk management and environmental and social impact[22]. Information disclosure is, in most cases, the first pillar of regulation to be developed, because informed decisions cannot be made about what is not known and has not been previously measured[23]. In order to facilitate this task, taxonomies of sustainable activities are emerging[24] developed both by regulators and independent organizations, which aim to establish official methods and classifications, as well as to promote uniform understanding of which activities are truly sustainable and thus combat the so-called greenwashing or socialwashing[25].

Regulation is being particularly intense in the financial sector to encourage the channeling of capital flows in a way that drives the transition to a sustainable, low-carbon economy. ESG risks, and in particular climate change, are seen as potentially relevant to the stability of the financial system. In particular, it is worth noting how the European Union (EU) has taken a leading role at the international level in terms of developing sustainability regulations in both the financial and non-financial sectors (figure 2), recognizing the business sector as a key player in this transformation process.

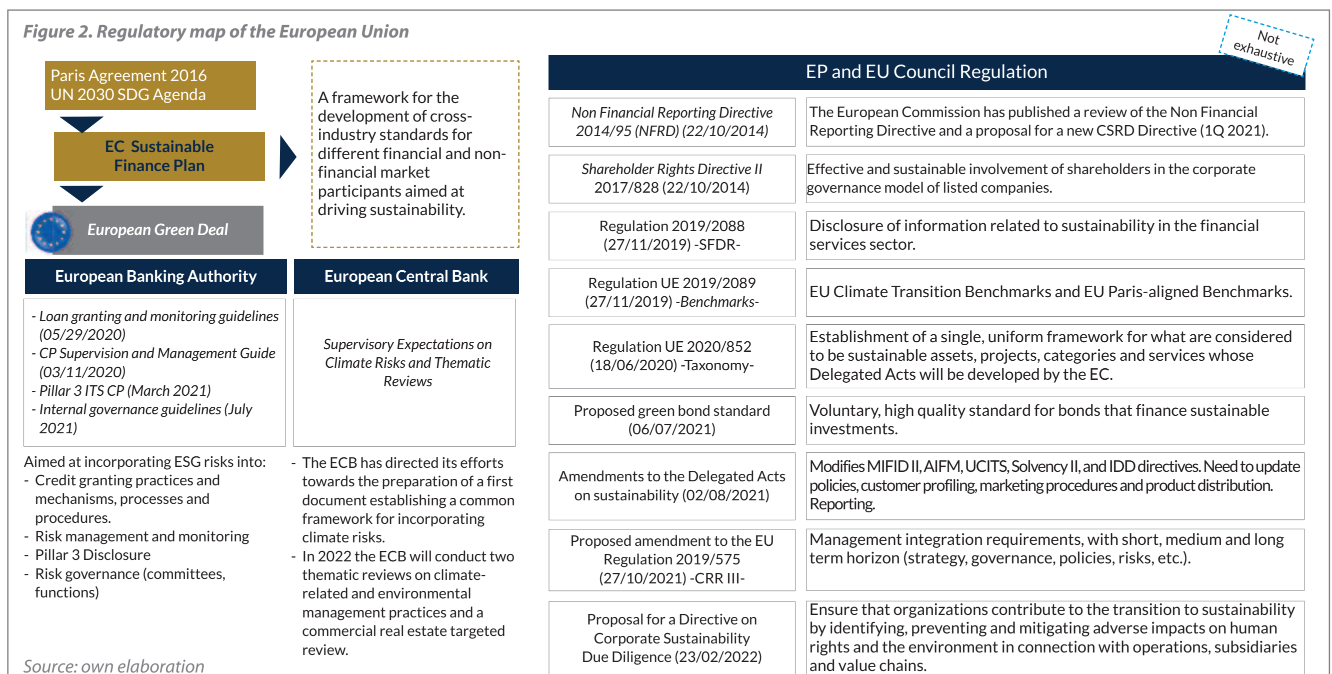
In November 2016, through the European Commission[26], the EU expressed its firm commitment to pioneering, together with its member countries, the implementation of the 2030 Agenda, paying particular attention to the impact of climate change on the economy and the promotion of sustainable finance.

- This commitment was first materialized through the Sustainable Finance Plan in March 2018[27], an ambitious package of measures to transition the economy to a more sustainable and carbon neutral model, including the enactment of the European Climate Act[28].

[22]The European Non-Financial Reporting Directive (NFRD), applicable since 2018, and the proposal for its revision and extension, the Corporate Sustainability Reporting Directive (CSRD) in 2021, applicable since 2018, and the proposal for its revision and extension, the Corporate Sustainability Reporting Directive (CSRD) in 2021. Other examples are the Modification of the Chilean Social Responsibility and Sustainable Development Report in 2019, or the United Kingdom's proposal in 2020.
[23]For more details, see the update on the new proposal for a European directive on disclosure of non-financial information (CSRD).
[24]Among the environmental taxonomies developedthe european taxonomy of 2020 stands out. There are other examples, such as the chinese taxonomy of 2020. An example of independent initiatives is the Mexican taxonomy published in 2020. Also noteworthy is the social taxonomy- related work currently being carried out by the EU's Sustainable Finance Platform, the result of which has been included in the first report published in February 2022.
[25]The presentation of misleading information about the (environmental or social) sustainability of an organization's activities and products, usually showing as sustainable what cannot be defined as such under official or scientific criteria.
[26]The European Commission itself outlined its strategic approach to the implementation of the 2030 Agenda, highlighting a number of key actions:
- Include the Sustainable Development Goals in EU policies and initiatives at all levels, with sustainable development as an essential guiding principle for all European Commission policies.
- Submit regular EU progress reports starting in 2017.
- Drive the implementation of the 2030 Agenda together with EU governments, the European Parliament, other European institutions, international organizations, civil society organizations, citizens and other stakeholders.
- Set up a high-level multilateral platform to support the exchange of best practices in implementation between the different sectors at national and European level, and define a long-term vision.

[27]European Commission (2018).
[28]European Commission (2021).

Figure 2. Regulatory map of the European Union



Source: own elaboration

- Following this, the European Commission[29] launched the Action Plan for Financing Sustainable Growth in 2018, giving rise to a veritable wave of regulatory requirements in the region[30].

On the other hand, special mention should be made of the launch of the Next Generation funds for the period 2021-2027 which, together with the EU long-term budget, have become a temporary instrument designed to boost recovery from the COVID-19 crisis, and the largest stimulus package ever financed in Europe. A total of[31] 2.018 trillion to help rebuild a greener, more socially and territorially cohesive Europe.

A document worth mentioning among the numerous publications arising from the European Action Plan[32]is the environmental Taxonomy[33], an official and detailed guide on which activities qualify as sustainable. To date, an Environmental Taxonomy has been published which sets out six objectives[34] and key climate and environmental aspects. For the first two objectives of the Taxonomy (climate change mitigation and adaptation), the detail of activities that substantially contribute to these two objectives was published in April 2021, along with the technical criteria for each. In addition, in July 2021, the Parliament and the Council of the European Union published the disclosure requirements and dates for both financial and non-financial firms. On the other hand, a report is expected to be published shortly by the European Commission on the possible extension of the European Taxonomy Regulation to address social, neutral and brown aspects.

However, this transition to a green economy will entail imbalances and an unequal distribution of the resulting costs, which is why it is essential to ensure proper coverage from a social perspective, trying to prevent any group from being left behind. To this end, in July 2021 the Technical Expert Group on sustainable finance appointed by the European Commission published a first draft of the social taxonomy, which will be revised in order to launch a final version of the report (initially expected by the end of 2021[35].

It can be observed that, despite the current rapid and comprehensive regulatory effort around sustainability, no standard refers strictly to how companies should undertake exercises to measure and manage externalities (social and environmental impacts beyond the scope of climate change). It could be said that, in this case, international standards are covering this lack of regulation and the elements to be considered:

[29]European Commission (2020).
[30]The three main objectives of the Action Plan for Financing Sustainable Growth are:
- Redirecting capital flows towards sustainable investment to ensure sustainable and inclusive growth.
- Managing financial risks related to climate change, environmental degradation and social issues.
- The promotion of transparency in ESG areas and long-term sustainability in financial and economic activity.

[31]In this document, monetary amounts are expressed using the long scale, whereby one billion equals one million million.
[32]For more details see figure 2 on "EU regulatory map".
[33]European Commission (2020).
[34](1) Climate change mitigation, (2) Climate change adaptation, (3) Sustainable use and protection of water and marine resources, (4) Transition to a circular economy, waste prevention and recycling, (5) Pollution prevention and control, (6) Protection of healthy ecosystems.
[35]Platform on Sustainable Finance (2022).

- Lack of uniformity: until now, there have been several standards that, working independently, have developed different frameworks for measuring and reporting impacts through the definition of metrics and criteria. This multiplicity of standards has generated some confusion among companies and investors.

- Need for consistency and comparability: as stated in the IFRS Foundation[36], based on comments from different stakeholders, both information requesters (regulators, central banks, auditors, etc.) and information providers (organizations, companies, banks, foundations, etc.), despite differences in scope and motivation, call for an urgent need to improve consistency and comparability in sustainability reports

  - First, investors are suffering from a lack of comparable and reliable data, failing to respond to the growing expectations of their respective clients and beneficiaries, while having to deal with insufficient data and analysis on investable sustainable assets.

  - On the other hand, business professionals also refer to the difficulties that exist around specialized requests for sustainability data, as there is no consistency or uniformity in the information requirements[37].

- Collaborative work: although there is still no single reference standard for the measurement and disclosure of social and environmental impacts, in recent years collaboration between the institutions that advance these standards has been encouraged in order to promote uniformity and the development of single, internationally recognized standards:

  - By September 2020, the organizations leading the way in integrated reporting and sustainability information (CDP[38], CDSB[39], GRI[40], IIRC[41] y SASB[42]) published a statement confirming their intention to cooperate[43] in order to develop a corporate reporting system for sustainability, seeking to alleviate the existing confusion.

  - The Value Reporting Foundation has emerged as a result of the merger between SASB and IIRC, due to the complementary nature of the reporting practices promoted by both.

  - GRI, Social Value International and the European Union have suggested and are promoting the development of a single accounting system capable of integrating social impacts (double materiality view[44]).

  - IFRS, which, together with the IASB, develops international financial reporting standards, has created a parallel Sustainability Board and is launching consultations with the aim of developing two formal accounting frameworks in parallel.

At present, this welter of norms and standards does not provide sufficient clarity for companies to measure the social and environmental impacts they generate. For this reason, and with the aim of assisting in these developments, the next section presents a methodological introduction to impact measurement.

[36]Paper consultivo de diciembre de 2020.
[37]For these reasons, and as the CEO of the Sustainability Accounting Standards Board (SASB) himself states, "both groups would benefit from standardized disclosure of the subset of sustainability issues most relevant to long-term financial performance in a given industry" (Janine Guillot, 2020).
[38]Carbon Disclosure Project.
[39]Climate Disclosure Standards Board.
[40]Global Reporting Initiative.
[41]Integrated Reporting.
[42]Sustainability Accountign Standards Board.
[43]Integrated Reporting.
[44]A perspective that advocates the consideration and integration by organizations of the externalities (social and environmental impacts) affecting investors and the rest of society/planet in general terms that are not reflected in financial accounting.

Main non-financial reporting standards

Agency	Target	Description	Integration/Collaboration Initiatives
Global Reporting Initiative (GRI)	• The Global Reporting Initiative is a pioneering, independent, international organization founded in 1999 to develop sustainability reporting standards for business. • These standards, called GRI Standards, are currently the most widely used internationally and establish a common framework and language for sustainability impact reporting and non-financial reporting.	• GRI supports the principle of double materiality, as it considers the impacts of the business activity on people and the planet in addition to the financial impact of sustainability issues on organizations. • The standards are structured into economic, social and environmental matters, with a number of foundational and cross-cutting standards that include corporate governance. Around 80% of the top 100 companies in 41 countries currently use the GRI guidelines to prepare their non-financial and sustainability reports.	• GRI collaborates in the same way with B Lab, an organization that has developed the B Impact Assessment tool for measuring and managing the impact of companies on their stakeholders.
Sustainability Accounting Standards Board (SASB)	• SASB is an independent, not-for-profit organization that develops and maintains disclosure standards enabling companies worldwide to identify, manage and communicate financially relevant sustainability information. • It aims to establish standards that ultimately improve the information available to decision-makers	• SASB standards consider the principle of simple materiality and are primarily designed to capture and satisfy the financial needs and concerns of investors (SASB, 2020) . • SASB has developed specific standards for 77 industries (identified in the Sustainable Industry Classification System). Each standard, applicable globally, covers industry-specific topics on which information should be disclosed, as well as accounting parameters. • SASB metrics capture essential operational aspects that drive long-term value creation through clear linkages to business strategy and financial performance. • For companies, they highlight key risk areas to mitigate and opportunities where improved performance can lead to higher profitability, increased revenue or competitive advantage (SASB, 2020).	• GRI and SASB announced a collaborative work plan that aims to study the use of both standards, the similarities and differences in the information generated by each, as well as potential areas for further collaboration
International Integrated Reporting Council (IIRC)	• The International Integrated Reporting Council (IIRC) is a global coalition of regulators, investors, companies, standards developers, accountants, academia and NGOs. • It has developed the Integrated Reporting Framework (IRF), a framework for reporting on the financial and non-financial aspects of an organization.	• The areas to be reported are classified into six forms of capital: financial, industrial, human, intellectual, social and natural. It does not establish specific metrics or prescribe a series of KPIs; it is a principles-based standard. It is based on a simple view of materiality in which the information considered is that which generates value primarily for the company's stakeholders. • An integrated report under the IRF framework should include the organization's business model, context and strategy; the governance model for value creation in the short, medium and long term; the risks and opportunities affecting the organization's ability to create value, and their management; the scope of the sustainability objectives established; the definition of the materiality of each area and methods of quantification and evaluation.	• In November 2020, SASB and IIRC announced their intention to merge into a single organization, the Value Reporting Foundation , due to their complementarity, and in order to simplify and make the current sustainability reporting ecosystem clearer and more uniform.
IFRS Foundation	• The IFRS Foundation is a not-for-profit organization created to develop globally accepted accounting standards - the IFRS Standards - and to promote and facilitate their adoption. • Its standards are created by the International Accounting Standards Board (IASB), which establishes the IFRS Accounting Standards for the preparation of financial statements. • In November 2021 IFRS Foundation announced the creation of the International Sustainability Standards Board (ISSB) that will establish the framework for the IFRS Sustainability Disclosure Standards.	• The intention is for the ISSB to provide a comprehensive, transparent and comparable global basis for sustainability-related disclosure standards that will provide investors and other capital market participants with information on companies' sustainability risks and opportunities to help them make informed decisions.	