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ISSB Consults on Proposed Sustainability-Related Financial and Climate-Related Disclosures Standards

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TO: ICI Members
ICI Global Members
ESG Advisory Group
ESG Task Force
EU ESG Disclosure Regulation Working Group SUBJECTS: ESG
International/Global RE: ISSB Consults on Proposed Sustainability-Related Financial and Climate-Related Disclosures Standards

On 31 March 2022, the International Sustainability Standards Board (ISSB) launched a consultation on its first two proposed IFRS Sustainability Disclosure Standards:

- IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information ("IFRS S1 Exposure Draft")[1] setting out the overall requirements for disclosing information about significant sustainability-related risks and opportunities; and
- IFRS S2 Climate-related Disclosures ("IFRS S2 Exposure Draft")[2] specifying requirements for the identification, measurement, and disclosure of climate-related financial information.

Building upon the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD), the proposals set out requirements for the disclosure of material information about a company's significant sustainability-related risks and opportunities that are necessary for investors to assess a company's enterprise value.

The two proposed standards also incorporate industry-based disclosure requirements derived from Sustainability Accounting Standards Board (SASB) Standards. The ISSB separately announced[3] plans for embedding SASB's industry-based standards development approach into its standards development process. The SASB Standards will serve as the starting point for the ISSB's industry-based requirements.

The consultation is open for public comments until 29 July 2022. In parallel with the ISSB's consultation exercise, the International Organization of Securities Commissions (IOSCO) will begin its review of the draft standards to determine whether they meet securities regulators' expectations prior to issuing its final endorsement.[4]

This memorandum summarizes the most significant aspects of the two proposed standards, with a full list of consultation questions included in Appendix A (attached).

IFRS S1 Exposure Draft - General Requirements for Sustainability-Related Financial Disclosure

The IFRS S1 Exposure Draft sets out the core content for a complete set of sustainability-related financial disclosures. It establishes a comprehensive baseline of sustainability-related financial information.[5] Entities would be required to disclose information required by the IFRS Sustainability Disclosure Standards as part of a company's general-purpose financial reporting. In other words, entities should publish sustainability-related financial disclosures at the same time as the financial statements.

General Features of Sustainability-Related Disclosure

Assessment of Materiality. An entity would be required to disclose material information about all significant sustainability-related risks and opportunities to which it is exposed, including information about impacts and dependencies on people, the planet, and the economy. The materiality judgment is proposed to be made in the context of the sustainability-related financial information necessary for investors to assess enterprise value.[6] Sustainability-related financial information is material if omitting, misstating, or obscuring such information could reasonably be expected to influence decisions that the investors make on the basis of that reporting. An entity need not provide that disclosure if the resulting information is not material. Materiality judgment should be reassessed at each reporting date to take account of changed circumstances and assumptions.

Information Related to Value Chain. The IFRS S1 Exposure Draft proposes to require the disclosure of material information about sustainability-related risks and opportunities across an entity's value chain. A value chain would encompass the activities, resources, and relationships an entity uses and relies on to create its products or service from conception to delivery, consumption, and end-of-life.[7] The information an entity would be required to provide is limited to that necessary to enable investors to assess the company's enterprise value.

Use of Estimates. It is noted that the use of reasonable estimates is an essential part of preparing sustainability-related metrics and does not undermine the usefulness of the information if the estimates are accurately described and explained. The IFRS S1 Exposure Draft proposes that an entity should identify metrics it has disclosed that cannot be measured directly and can only be estimated. For these metrics, the entity should disclose the sources and nature of the estimation uncertainties and the factors affecting the uncertainties.

Connected Information. An entity would be required to explain the connections between different pieces of information, including various sustainability-related risks and opportunities and connections with the information in the entity's financial statements. For instance, an entity should integrate its disclosure on governance rather than providing separate governance disclosures for each significant sustainability-related risk and opportunity.

Fair Representation. To identify significant sustainability-related risks and opportunities, the IFRS S1 Exposure Draft proposes that an entity should not only apply the IFRS Sustainability Disclosure Standards but also consider the disclosure topics[8] in the industry-based SASB Standards, the ISSB's non-mandatory guidance (such as Climate Disclosure Standards Board Framework application guidance for water- and biodiversity-related disclosures), the most recent pronouncements of other standard-setting bodies whose requirements are designed to meet the needs of users of financial reporting, and the sustainability-related risks and opportunities identified by entities that operate in the same industries or geographies. In the absence of an IFRS Sustainability Disclosure Standard that applies specifically to a sustainability-related risk and opportunity, an entity should use its judgment in identifying disclosures that would be relevant to the decision-making needs of investors.

Core Content of Sustainability-Related Financial Disclosure

Responding to the feedback on key requirements for success received from the International Financial Reporting Standards (IFRS) Foundation's 2020 consultation on sustainability reporting, the IFRS S1 Exposure Draft builds upon the TCFD's recommendations.[9] The sustainability-related financial information disclosure is proposed to be centered on an entity's consideration of its governance, strategy, risk management, and metrics and targets.

Governance. An entity would be required to disclose information about (i) the governance body or bodies (which can include a board, committee, or equivalent body charged with governance) with oversight of sustainability-related risks and opportunities, and (ii) management's role in those processes.

Strategy. An entity would be required to disclose information about how significant sustainability-related risks and opportunities could reasonably be expected to affect its (i) business model, (ii) strategy and cash flow over the short, medium, or long term, and (iii) access to finance and cost of capital.

The IFRS S1 Exposure Draft further proposes that an entity should describe the resilience of its strategy, including its business model, to the significant sustainability-related risks and opportunities. Other IFRS Sustainability Disclosure Standards will specify the type of information an entity is required to disclose about its resilience to specific sustainability-related risks, such as when scenario analysis should be used. For instance, the IFRS S2 Exposure Draft proposes the use of scenario analysis in assessing an entity's climate resilience (See Section 2B for further information).

Risk Management. The IFRS S1 Exposure Draft proposes that an entity should describe the processes an entity uses to identify, assess, prioritize, monitor, and manage sustainability-related risks and opportunities. It should also provide information on the extent to which and how these processes are integrated into the entity's overall risk management process.

Metrics and Targets. An entity would be required to disclose the metrics it uses to manage and monitor sustainability-related risks and opportunities, and the targets it has set to assess progress towards achieving its strategic goals. These should include:

- metrics defined in any other applicable IFRS Sustainability Disclosure Standards, e.g., the IFRS S2 Exposure Draft;
- metrics associated with the disclosure topics in the industry-based SASB Standards,

the ISSB's non-mandatory guidance, the most recent pronouncement of other standard-setting bodies whose requirements are designed to meet the needs of users of financial reporting, and the metrics used by entities in the same industries or geographies; and
- metrics developed by an entity itself.

IFRS S2 Exposure Draft - Requirements for Climate-Related Disclosure

The IFRS S2 Exposure Draft proposes that an entity should disclose material information about its significant climate-related risks and opportunities in order to assist investors to assess the effect of climate-related risks and opportunities on its enterprise value.

In line with the approach proposed in the IFRS S1 Exposure Draft, an entity should center its disclosures on the consideration of the governance, strategy, and risk management of its business, and the metrics and targets it uses to measure, monitor, and manage its significant climate-related risks and opportunities. The IFRS S2 Exposure Draft further proposes industry-based disclosure requirements,[10] which have been derived from the SASB Standards.

Governance

An entity would be required to disclose information about the governance processes, controls, and procedures it uses to monitor and manage climate-related risks and opportunities. This includes a description of the governance body, e.g., a board, committee, or equivalent body charged with governance, with oversight of climate-related risks and opportunities, and a description of management's role regarding climate-related risks and opportunities.

While the governance disclosure requirements are proposed based on the TCFD's recommendations, the IFRS S2 Exposure Draft proposes more detailed disclosure on some aspects of climate-related governance and management. For example, it proposes a requirement for entities to disclose how the governance body's responsibilities for climate-related risks and opportunities are reflected in the entity's terms of reference, board mandates, and other related policies.

Strategy

An entity should disclose information about the climate-related risks and opportunities that could affect an entity's business model and strategy over the short, medium, and long term, as well as the effects of these climate-related risks and opportunities on its (i) business model, (ii) strategy and cash flows, (iii) its access to finance and its cost of capital over the short, medium, or long term.

Identification of Climate-Related Risks and Opportunities. In identifying the climate-related risks, the entity should further identify whether such risks are physical risks or transition risks, and explain whether such physical risks are acute or chronic. In addition, the IFRS S2 Exposure Draft proposes that an entity should refer to the disclosure topics defined in the industry-based disclosure requirements set out in Appendix B when identifying the significant climate-related risks and opportunities. Please refer to Section 2E below for disclosure topics for asset management activities.

Effects on Strategy and Decision-Making. It is proposed that an entity should disclose the effects of significant climate-related risks and opportunities on its strategy and decision-making, including its transition plans towards a lower-carbon economy. This includes information about its plans for responding to the significant climate-related risks and opportunities, plans to achieve any climate-related targets that it has set, and quantitative and qualitative information about the progress of these plans previously disclosed by the entity. In particular, an entity should disclose whether carbon offsetting is part of its plans in achieving emissions targets. Where carbon offsets are used, an entity should disclose specific information to enable an investor to assess the offset schemes, for instance, the basis of the offsets' carbon removal (nature- or technology-based) and the third-party verification or certification scheme for the offsets.

Effects on Financial Position, Financial Performance, and Cash Flows. The IFRS S2 Exposure Draft proposes that an entity should explain how significant climate-related risks and opportunities have affected its most recently reported financial position, financial performance, and cash flows. The entity should also explain how it expects its financial position to change over time given its strategy to address significant climate-related risks and opportunities.

Resilience to Climate-Related Risks. The IFRS S2 Exposure Draft proposes that an entity be required to use climate-related scenario analysis to assess its climate resilience unless it is unable to do so. Where using climate-related scenario analysis is not possible, an entity should provide an explanation of why this scenario analysis was not conducted and use an alternative method or technique to assess its climate resilience, for instance, single-point forecasts, sensitivity analysis, or qualitative analysis. In either case, an entity would be required to disclose the result of the analysis of climate resilience, such as impacts on the entity's decisions and performance, and explain how the analysis is conducted.

Risk Management

An entity would be required to disclose information about the processes it uses to manage climate-related risks and opportunities. It should explain the extent to which and how the processes to identify, assess, and manage climate-related risks and opportunities are integrated into its overall risk management process. It should also disclose how it prioritizes climate-related risks relative to other types of risks, including its use of risk-assessment tools.

Metrics and Targets

Cross-Industry Climate-Related Metrics. The IFRS S2 Exposure Draft proposes incorporating the TCFD's concept of cross-industry metrics with the aim of improving the comparability of disclosures across reporting entities regardless of industry. Subject to materiality, an entity would be required to disclose the below seven cross-industry metric categories:

- Greenhouse Gas (GHG) Emissions - Absolute Scope 1, Scope 2, and Scope 3, emissions intensity;
- Transition Risks - Amount and extent of assets or business activities vulnerable to transition risks;
- Physical Risks - Amount and extent of assets or business activities vulnerable to physical risks;
- Climate-related Opportunities - Amount and percentage of assets or business activities aligned with climate-related opportunities;
- Capital Deployment - Amount of capital expenditure, financing, or investment

deployed toward climate-related risks and opportunities;
- Internal Carbon Prices - Price for each ton of GHG emissions used to assess the cost of an entity's emissions, and an explanation of how the carbon price is applied in decision-making;
- Remuneration - Percentage of executive management remuneration linked to climate-related considerations.[11]

Specifically for disclosure of Scope 3 GHG emissions, the IFRS S2 Exposure Draft proposes that an entity should include upstream and downstream emissions in its measure of Scope 3 emissions.

Industry-based Climate-Related Metrics. In addition to the above cross-industry metrics, an entity should also disclose industry-based metrics which are associated with the disclosure topics and relevant to its industry, as set out in Appendix B. Please refer to Section 2E below for industry metrics for asset management activities.

Climate-related Targets. An entity would be required to disclose information about its emission-reduction targets, including the objective of the target, metrics used to assess progress towards reaching the target, as well as information about how the entity's targets compare with those prescribed in the latest international agreement on climate change.

Disclosure Topics and Metrics for Asset Managers

Derived from the SASB Standards, the IFRS S2 Exposure Draft proposes industry-based requirements in Appendix B that address significant climate-related risks and opportunities. The proposed industry-based disclosure requirements are largely unchanged from the equivalent requirements in the SASB Standards. Nevertheless, in order to address risks from financed or facilitated emissions, the IFRS S2 Exposure Draft proposes adding disclosure topics and associated metrics in four financial industries, namely, commercial banks, investment banks, insurance and asset management. As a result, below are the sustainability disclosure topics and associated metrics for asset management activities:[12]

Disclosure Topic: Incorporation of Environmental, Social, and Governance Factors in Investment Management & Advisory. Under such topic, asset managers would be required to disclose:

- Amount of assets under management by asset class, that employ (i) integration of ESG issues, (ii) sustainability-themed investing, and (iii) screening;
- Description of approach to incorporation of ESG factors in investment and/or wealth management processes and strategies; and
- Description of proxy voting and investee engagement policies and procedures.

Disclosure Topic: Transition Risk Exposure. Under such topic, asset managers would be required to disclose:

- Percentage of total assets under management included in the financed emissions calculation;
- Absolute gross (i) Scope 1 emissions, (ii) Scope 2 emissions, and (iii) Scope 3 emissions, and associated amount of total AUM (i.e., financed emissions);
- Gross emission intensity by (i) Scope 1 emissions, (ii) Scope 2 emissions, and (iii) Scope 3 emissions, and associated amount of total AUM (i.e., financed emissions); and
- Description of the methodology used to calculate financed emissions.

Next Steps

The ISSB plans to consider the comments in the second half of 2022 and aims to finalize the requirements by the end of 2022.

Moreover, it intends to consult on its standard-setting priorities later in 2022. It will seek feedback on the sustainability-related information needs of investors when assessing enterprise value and on the further development of industry-based requirements, building on SASB Standards, which address a broad range of sustainability matters.

Lisa Cheng
Research Analyst
ICI Global

endnotes

[1] See [Draft] IFRS S1 General Requirements for Disclosure

of Sustainability-related Financial Information, March 2022, available at https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf.

[2] See [Draft] IFRS S2 Climate-related Disclosures, March 2022, available at https://www.ifrs.org/content/dam/ifrs/project/climate-related-disclosures/issb-exposure-draft-2022-2-climate-related-disclosures.pdf.

[3] See ISSB communicates plans to build on SASB's industry-based Standards and leverage SASB's industry-based approach to standards development, dated 31 March 2022, available at https://www.ifrs.org/news-and-events/news/2022/03/issb-communicates-plans-to-build-on-sasbs-industry-based-standards/?utm_medium=email&utm_source=website-follows-alert&utm_campaign=immediate.

[4] See IOSCO welcomes ISSB's publication of sustainability standards exposure drafts, dated 31 March 2022, available at https://www.iosco.org/news/pdf/IOSCONEWS638.pdf.

[5] Sustainability-related financial information refers to information that gives insight into sustainability-related risks and opportunities that affect enterprise value, providing a sufficient basis for users of financial reporting to assess the resources and relationships on which an entity's business model and strategy for sustaining and developing that model depend. See IFRS S1 Exposure Draft, supra note 1, at Appendix A, p.41.

[6] Enterprise value reflects expectations of the amount, timing, and uncertainty of future cash flows over the short, medium, and long term, and the value attributed to those cash flows. See IFRS S1 Exposure Draft, supra note 1, at paragraph 5.

[7] See IFRS S1 Exposure Draft, supra note 1, at Appendix A, p.41.

[8] A disclosure topic is a specific sustainability-related risk or opportunity based on the activities conducted by entities within a particular industry as set out in an IFRS Sustainability Disclosure Standard or an industry-based SASB Standard. See IFRS S1 Exposure Draft, supra note 1, at Appendix A, p.40.

[9] ICI responded to the IFRS Foundation's consultation on whether it should create a second board - the Sustainability Standards Board (SSB) in December 2020. We strongly encouraged the IFRS Foundation to leverage the TCFD's recommendations on climate-related disclosure and emphasized the importance of SASB's industry-specific approach to disclosure. See ICI Memorandum [33015], dated 4 January 2021, available at https://www.ici.org/memo33015.

[10] See IFRS S2 Exposure Draft, supra note 2, at Appendix B, p.49.

[11] Further details on the cross-industry climate-related metric categories can be found in the IFRS S2 Exposure Draft at paragraph 21.

[12] Further details on industry-based disclosure requirements proposed for asset management activities, please refer to [Draft] IFRS S2 Climate-related Disclosures - Appendix B Industry-based disclosure requirements: Volume B15—Asset Management & Custody Activities, March 2022, available at https://www.ifrs.org/content/dam/ifrs/project/climate-related-disclosures/industry/issb-exposure-draft-2022-2-b15-asset-management-and-custody-activities.pdf.
