IRSG

INTERNATIONAL
REGULATORY
STRATEGY GROUP

29th July 2022

IRSG Comment letter: ISSB consultation on a comprehensive global baseline of sustainability disclosures (IFRS S1 and IFRS S2)

The International Regulatory Strategy Group (IRSG) is a practitioner-led body comprising leading UK based representatives from the financial and related professional services industry. It is an advisory body both to the City of London Corporation, and to TheCityUK. Its remit is to provide a cross-sectoral voice to shape the development of a **globally coherent regulatory** framework that will facilitate open and competitive cross-border financial services.

The IRSG welcomes the opportunity to contribute the following comments, in response to the ISSB publication of the exposure draft consultations.

In responding, we would like to highlight the following comments from our members:

International interoperability on sustainability reporting

- The IRSG welcomes the Exposure Drafts and the work of the ISSB towards global coherence in reporting standards. It is of utmost importance that we build an **effective international framework for sustainability reporting**, which will maximise the **interoperability of local reporting standards**, **avoid fragmentation and regulatory arbitrage**, promote greater transparency, consistency, and comparability of disclosures, and reduce reporting costs and operational burdens. The IRSG therefore welcomes the formation of the new ISSB platform as a means **to enhance cross-jurisdictional coherence** and is encouraged by the support that it has been given by the G7 and G20.
- The IRSG believes that **jurisdictional approaches to sustainability information should converge around the ISSB baseline standards**, which could form the basis for counterparty information required to meet sustainability disclosure requirements for international companies. On climate, investors need sustainability data in the form of consistently calculable and widely applicable metrics, and detailed transition plans. Thus, we welcome the high degree of alignment between the standards recently proposed by the U.S. Securities and Exchange Commission (SEC) and the ISSB, which are both based on the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD).
- We are also encouraged that, **for the climate reporting aspects of the CSRD, EFRAG has been closely engaged with the ISSB technical work** and the two standards are overall well aligned (though with the important exception of EFRAG's inclusion of the Taxonomy and SFDR related disclosures that are necessitated by the overall EU sustainable finance regime). We believe that the main challenges ahead will be (i) to **maintain a high degree of convergence despite different standards approval processes and timelines** and to (ii) **converge on other environmental and social considerations**. It is important to properly calibrate disclosures requirements in order to embark the largest number of businesses, listed or not, from developed and developing countries, in this effort.

The IRSG believes that while the standards and regulation pertaining to sustainability is at an early stage of evolution for investors and asset owners, **linkages into PRI, World Benchmarking Alliance and UNDP would be useful** given the increasing expectation of asset pools to express their sustainability risks and opportunities. Other related investor sustainability standards include Global ESG Disclosure Standards for Investment Products (cfainstitute.org).

Data availability

- The IRSG welcomes the ISSB exposure drafts for working toward a global baseline standard which will provide **structure and comparability across jurisdictions and firms worldwide**. We recognize this may be a multi-year process and so policy continuity to build on already existing industry-adopted frameworks will be important.
- **Access to data and the quality of that data remain key barriers** to reliable and comparable disclosures. A **single set of comprehensive disclosure standards** — applying to **both financial and non-financial firms** — is critical in building the necessary data sets to facilitate better investment and financing decisions by all stakeholders.
- **Clarity from data regulators on both the basis for collecting and sharing such data across borders** is increasingly important as there is a growing trend of data sovereignty and localization, and restrictions on the flow of data. The IRSG has recently published reports on data localization and on international data transfers.
- It is critical that a **common set of internationally recognized standards is developed** to **avoid unnecessary duplication across diverse supply chains**. For example, mid-tier businesses supplying a variety of larger firms could end up in the position of completing several processes that all basically consist of the same information, incurring a significant administrative burden, as each firm has its own standards. The ISSB is well placed to champion this global coordination to reduce friction and support the transition.

Enterprise Value and material sustainability risk/opportunity

- The IRSG believes that the definition of "**enterprise value**", the core subject of materiality assessments, needs clarification and enhancement. There is potential for varying interpretations in different jurisdictions, leading to comparability issues. One option is to use enterprise value including cash (EVIC) (sum of the equity and debt of the firm), as per the Partnership for Carbon Accounting Financials (PCAF) standards.
- The PRI, UNEPFI legal framework for Impact report sets out that investing for sustainability impact is indeed permissible under pension fund fiduciary responsibility. The definitions of companies' materiality in relation to its impact on short-, medium- and long-term enterprise value has relevance ultimately to the chain of accountability.
- A further reason for **increased clarity being required relates to the enterprise value definition**. How can an investor or asset owner assess whether the appropriate sustainability matters have been disclosed, especially where they may not be interpreted as material from an individual corporate's perspective.

- The MoU with GRI would appear to start to address the above, but **further clarity on their involvement** would be useful. Is it envisaged to merge the GRI board and the ISSB to ensure some oversight of material sustainability matters are still highlighted for investors, even if not considered material to the company.
- **Forward looking data and information would be needed** to ensure sustainability risks and opportunities are appropriately assessed.
- The IRSG believes that the ISSB should **consider encouraging the usage of other metrics of climate transition, beyond emissions, that are more sensitive to financial risk**. Examples are the *Scenario Value at Risk* (the impact on asset prices of a 'well below' 2C scenario) or the *PRA/FCA's Climate Financial Risk Forum's guide on Climate metrics*.[1]
- Their absence makes it increasingly challenging for investors receiving this information and other stakeholders to make decisions on the likely effect of sustainability issues on overall portfolio of assets.

Timelines, frequency, transition periods

- The IRSG recommends **focusing first on climate-related disclosure**, i.e., publishing and implementing IFRS S2 *before* S1. Adopting both standards in parallel would be challenging and operationally burdensome for companies. But even if this sequencing is a pragmatic necessity the ISSB should continue its work on broader disclosures, not least to **signal its leadership on this broader agenda.**
- Climate-related disclosures often require companies to collect and aggregate data from various internal and external source **Adequate timing** should be provided to give preparers the opportunity to provide a meaningful report. It would be very challenging to achieve disclosure for YE 2023, particularly given the need for extensive data from third parties (clients). The IRSG recommends that there should be **flexibility** in scope and timelines, to account for operational challenges that this will place on companies to meet the requirements.
- The IRSG proposes that there should be a **transition period for less mature elements of sustainability reporting**, during which reporting can be provided on a "best effort" basis — e.g., scope 3/financed emissions - while data and methodologies are improved. Such a transition period would avoid confusion for users of disclosures and reduce liability risk for preparers. A target date could be set for all preparers to plan around and to drive synchronized implementation. Even where data is available, significant development is needed in data capture and reporting capabilities/controls. The IRSG welcomes the ability to use qualitative impact assessments where quantitative are not available.

Scope, phasing, proportionality

- It is important that **disclosure requirements are proportionate**. There is **concern about the amount of data required** and associated burden on firms, and the IRSG therefore recommends that disclosure requirements are focused on those areas that are material to a firm's value. This is particularly the case for broader sustainability which is less well developed.

[1] https://www.fca.org.uk/publication/corporate/climate-financial-risk-forum-guide-2021-data-metrics.pdf (Page 13 shows a dashboard of metrics – with detailed examples of each - including scenario value at risk)

- The IRSG proposes **clear definitions of a range of key terms**. Interpretation guidance or a fuller glossary accompanying the guidance could help clarify some of these definitions.
- Poor definitions of "material" and "risks/opportunities" could create challenges in undertaking analysis across supply chains, second-derivative impacts, and lead to firms' being forced to demonstrate to auditors why something is not material – which could be a significant burden. One option could be to **allow firms to define materiality in line with any definition a firm has applied in auditing its financial accounts when assessing risks and opportunities**.
- The IRSG notes that dozens of environmental and social KPIs required by the EFRAG on environmental aspects are currently almost never reported by companies (e.g. Gravel withdrawals, Deep-sea minerals withdrawals, Total water stored, Potential financial effects of material risks and opportunities arising from water and marine resources-related impacts and dependencies,
- Social security eligibility coverage, Work-Life Balance indicators, etc). Therefore, given the current limitations in capturing data on social issues, it may be helpful to begin by **encouraging reporting on few material issues**.
- The ISSB exposure drafts draw heavily on the 2021 guidelines of the Taskforce on Climate-Related Financial Disclosure (TCFD). Many financial services firms continue to build their capacity to comply with the TCFD's 2017 guidelines, let alone the 2021 guidelines. While we support the ambition of the ISSB's approach, the ISSB guidelines must **retain space for iterative improvement** from the existing level of implementation.
- For climate-related disclosures, the **ISSB might provide safe harbour provisions** covering Scope 3 emissions, transition plans and scenario analysis disclosures.

Alignment with general reporting

- While the IRSG is broadly supportive of the proposal to **report sustainability-related financial information as part of general-purpose reporting**, there is concern that this could lead to increasingly long annual or similar reports, which in turn could lead to pressure to reduce disclosure as firms seek to shorten their wider reports.
- The IRSG recognizes the advantages of publishing sustainability-related financial information **at the same time** as general-purpose reporting so that the data can be considered together, highlighting inter-relationships and connections across the risks and opportunities. However, some degree of **flexibility** would be welcomed **so that firms can decide whether to include some of this information in the financial reports or in separate documentation**.

Global adoption of standards

- While the IRSG believes that jurisdictional approaches to sustainability information are likely to converge around the ISSB standards, significant challenge in **ensuring global adoption of the standards remain.** These exist both in jurisdictions with existing disclosure regimes (such as Europe's CSRD and the U.S. if the SEC proposed disclosures do not permit ISSB disclosures for foreign issuers) and for more emerging markets where TCFD reporting may not have yet been adopted.
- In this context, the IRSG welcomes the new ISSB working group seeking to **enhance cross-jurisdictional coherence**. The IRSG also welcome the **UK government's commitment that the ISSB**

standards will form a core component of the SDR framework, and the backbone of its corporate reporting element.

- It is important to ensure that the framework is **'workable' enough to be adopted globally** (including in those jurisdictions where current corporate sustainability reporting practices are less advanced). If we are to both deliver a more sustainable financial system and retain the benefits that come from global adoption of standards, the existing **strong supervisory cooperation should be enhanced further.**
- The IRSG feels it is important to **encourage adoption of the standards as a baseline** and starting point for reporting, and direct comments at improvements, which could be made to help support adoption and further iterations.
- In addition, **close international dialogue** and multilateral cooperation between policymakers and industry will be required to ensure that a harmonised framework is accepted by all parties and is reflected in regulatory and policy instruments, and by firms in their planning processes.
- **Strong and close ongoing communication** promotes trust and improves the effectiveness of regulatory and supervisory processes.

Focus on climate

- Given the **urgency of the climate challenge**, we support the IFRS Foundation's focusing initially on climate change, before broadening the scope of sustainability reporting.
- Beginning with a more limited scope, the ISSB should be able to progress more quickly, especially if the ISSB were able to **leverage the work that the standard-setters are currently doing to build the foundation for a climate standard**.
- However, it will be important for the ISSB to plan for **broadening the scope going forward**, ultimately covering the entire range of ESG reporting. **Stronger support for rapid clarification on the S in ESG is needed** as the climate issues will not be solved without a holistic assessment of ESG factors as we have seen from the rapid growth in the Just Transition movement.
- If the ISSB does not develop plans to broaden scope, there is a risk that other initiatives may fill the void further increasing fragmentation.

Governance

- The IRSG would like to highlight the need for the chair and vice-chairs to appoint a full board. It is vital that there is seen to be **proper governance** around the framework.
- There are **clear advantages for legitimacy and credibility** of the end framework being signed off by a full board (that has the right expertise and coverage).
- The IRSG would be grateful for **more clarity on the multi-stakeholder input and participation in the process**, e.g. UN bodies, the World Bank, as well as the inclusion / merger with the GRI board. More clarity on the link with the ISO Sustainable Finance Standard 32210 Technical working group would also be welcomed.

For any questions or clarifications please contact: IRSGsecretariat@cityoflondon.gov.uk