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International Sustainability Standards Board (ISSB)
Emmanuel Faber, ISSB Chair
Sue Lloyd, ISSB Vice-Chair

Brussels, 29 July 2022

Subject: ISSB Exposure Drafts IFRS S1 on Sustainability-related Disclosures and IFRS S2 on Climate-related Disclosures

Dear Chair Faber and Vice-Chair Lloyd,

Finance Watch welcomes the opportunity to comment on the ISSB work on the exposure drafts for international financial reporting standards on sustainability and climate-related disclosures.

A fundamental change in the outside-in only approach taken to financial materiality, or risks and opportunities, is needed in the current drafts. This is essential if the standards aim to take a step towards creating a global framework that ensures transparency and accountability for companies and investors. We urge the ISSB to embed the double materiality principle in the global baseline standards acknowledging the importance of disclosures on impacts that businesses have on people and the environment. They are of particular relevance for the growing number of investors. They are also needed to properly evaluate and design climate targets and transition plans.

This is not only key to assess the impact of economic activity on the planet's sustainability, but, as importantly, has an obvious impact on financial materiality. This is because as the world becomes less and less sustainable, business's risks are on the rise and its opportunities diminish[1]. If the draft standards do not consider inside-out impact materiality, they will not be useful to assess properly the outside-in effect of climate change on companies. The standards must be built on the basis that impact materiality feeds financial materiality.

In addition to the issue of the approach towards the materiality principle, there is also one major gap in the current exposure drafts that needs to be filled. The current proposal for transition plans leaves the possibility for greenhouse gas (GHG) emissions reduction targets not to consider absolute emissions. Entities should disclose both intensity and absolute targets, rather than choosing between them. If plans are not linked to absolute emissions reduction targets, then investors and companies will have no guarantee of receiving a core part of the information on entities' strategies, or a way to measure track record on climate and sustainability[2]. Transition plan requirements are set to be at the heart of sustainability disclosures and will be required by law in many jurisdictions like the European Union. It is therefore of the utmost importance to ensure that reporting standards provide the right tools to assess the direction and are consistent with the aims of disclosing entities' strategies and progress towards reduction targets.

Additionally, climate targets need to be broken down into short-medium-term and long-term targets, ideally with a requirement to align the timeframes and the base year. Inspiration could be taken from the European Sustainability Reporting Standards (ESRS), which prescribe a 5-year rolling basis as from 2025 to enable comparability. A crucial adjustment is also needed to ensure that targets include actions to be taken if the climate-related target is not reached.

[1] See the component reports of the IPCC Sixth Assessment Report, https://www.ipcc.ch/reports/.
[2] Philipponnat, Thierry, The Problem Lies in the Net: Making Finance contribute to a Net Zero Economy, June 2022.

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The drafts include important provisions on disclosing GHG emissions, climate targets and to what extent remuneration of executive management is linked with sustainability and, in particular, climate-related targets and considerations. The provisions on percentage alignment of executive remuneration help to complete the view of where priorities are being set. These are good starting points to allow oversight of climate commitments and to point to where sustainability considerations need to be integrated into corporate decision-making structures, strategies and risk management.

A key upgrade that can build on the double-materiality approach is to create more robust requirements for defining sustainability and climate-related risks. To do this the double-materiality logic should expand the scope of the standards beyond enterprise value of entities and extend to the value chain and environment they operate in. It should take into account economic activity or enabling of economic activity of entities that results in sustainability or climate impact[3]. Specific provisions on risks arising from high GHG-emitting sectors could also be considered, in particular where new or expanded activity in these sectors is being enabled. Existing Finance Watch work on banking and insurance prudential regulation could provide the basis for a differentiated approach to existing and new or expansion high GHG-emitted sector activity[4].

Another area of improvement that the double-materiality approach can bring is to extend the scope of the draft standard on sustainability-related disclosure beyond climate. As part of a more robust view on impact that comprises the full value-chain and operating environment, mitigation, resilience and adaptation should also be dealt with. This more comprehensive approach should consider social and human rights issues around just transition, which is part of the cost and impact of climate change on entities. Capturing this broader view is also essential to ensuring that the connected nature of risks and opportunities for entities is clear. It should comprise social impact and environmental impact extended to biodiversity.

A last key area that the ISSB must consider with the exposure drafts and the proposed standards is the alignment and consistency with other ongoing work on reporting standards. The European Financial Reporting Advisory Group (EFRAG) is delivering European Sustainability Reporting Standards and is already quite advanced in this process. The ISSB and EFRAG must work together to ensure the compatibility and interoperability of the two sets of standards. A starting point could be to build on the EFRAG assessment of the two sets of proposed standards as a basis for exchanges and collaboration. The close exchanges that have recently started between the ISSB and the EFRAG should continue with efforts to align with the ESRS, looking at where detail and granularity can be added to the exposure drafts.

Finance Watch looks forward to continue contributing to the process of developing global standards to ensure availability of more consistent, complete, comparable and verifiable sustainability and climate-related information.

Yours sincerely,

Benoît Lallemand

[3] Symon, Julia, A silver bullet against green swans: Incorporating climate-related financial risk into bank and insurance prudential rules, November 2021.

[4] Philipponnat, Thierry, Breaking the climate-finance doom loop, June 2020 and Norwood, Peter, Insuring the uninsurable, July 2021.