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Finance Watch, Brussels

28/02/2023

Finance Watch consultation response to UK's Transition Plan Taskforce Framework and Guidance Consultation

[Text in yellow is the Finance Watch response. Text in red indicates the option selected]

Definition

The TPT Framework includes a definition of a transition plan. How would you describe this
definition?

a) The definition is complete and provides a sound basis for transition planning.

b) Overall, the definition provides a sound basis for transition planning, but there are relevant omissions.

c) The definition does not provide a sound basis for transition planning.

d) Don't know

If b) or c): Please explain why you gave that answer: [Free Text]

[ref page 8 Disclosure Framework]

The reference to an entity's "contribution to" net zero transition could be replaced with a clear reference to the entity´s effort in mitigating its impact on the environment.

The reference to urgency and alignment with climate neutrality is buried in footnote 9. We suggest bringing it into the main text.

We welcome that transition plans should embody ambition, action and accountability. We would add integrity to this list: that entities do not avoid difficult decisions or awkward disclosures

Where & how to disclose: User Feedback

In both the TPT Framework and the Implementation Guidance, we recommend that entities:

a. Publish a standalone transition plan,

b. Update the standalone transition plan at least every three years or sooner where there have been substantive changes, and

c. Report progress against the plan and all other content in the plan that is deemed to be
material to investors, consistent with corporate reporting norms, as part of annual TCFD- or ISSB-aligned disclosures in general purpose financial reporting.

[ref page 12-13 Disclosure Framework]

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If your entity is a user of transition plans, how helpful do you find these recommendations?

a. Publish a standalone transition plan

- Very helpful
- Helpful
- Neither helpful nor unhelpful
- Unhelpful
- Not sure

Please explain your selection for a, including by providing relevant information on the drawbacks and benefits of using a standalone plan: [Free Text]

This will give the plan more attention and help to align the process with requirements in other legislation, such as potential future EU requirements for prudential transition plans for banks and insurers. Interim updates would also be justified where there have been deviations from achieving the targets based on annual reporting.

b. Update the standalone transition plan at least every three years

- Very helpful
- Helpful
- Neither helpful nor unhelpful
- Unhelpful
- Not sure

Please explain your selection for b, including by providing relevant information on the drawbacks and benefits of using a standalone plan that is periodically updated: [Free Text]

b. A regular publication cycle would support the breakdown of targets into short- and medium- and long-term goals and provide a natural opportunity for interim targets to be updated.
Reporting entities should have sufficient flexibility to align their reporting cycle with sustainability and/or transition plan obligations in other jurisdictions.
Transition reporting should include a timeline for remedial actions to be taken when interim targets are not reached.

c. Report progress against the plan and all other material content, consistent with corporate reporting norms, as part of annual TCFD- or ISSB-aligned disclosures

- Very helpful
- Helpful
- Neither helpful nor unhelpful
- Unhelpful
- Not sure

Please explain your selection for c, including by providing relevant information on the drawbacks and benefits of accessing transition plan related information in general purpose financial reporting: [Free Text]

c. Please see our answers to the questions below on linking to financial statements and materiality.

Where & how to disclose: Reporting Norms

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The Implementation Guidance contains guidance on the implications of five key reporting
norms from the TCFD and ISSB for transition plans. If your entity has prepared a transition plan,
or is planning to prepare a transition plan: do you think the guidance provided is useful in
supporting effective disclosure and sufficiently detailed?

[ref: Implementing Guidance, page 25-26]

Reporting Boundaries

a. The guidance is useful in supporting effective disclosure and is sufficiently detailed.
b. The guidance is useful in supporting effective disclosure but lacks sufficient detail.
c. The guidance is not useful in supporting effective disclosure.
d. Don't know

If b) or c): Please explain why you gave that answer: [Free Text]

no comment on reporting boundaries

Links between climate-related disclosures and financial statements

a. The guidance is useful in supporting effective disclosure and is sufficiently detailed.
b. The guidance is useful in supporting effective disclosure but lacks sufficient detail.
c. The guidance is not useful in supporting effective disclosure.
d. Don't know

If b) or c): Please explain why you gave that answer: [Free Text]

Not useful.
Please see our response to the next question with respect to the financial vs impact materiality in regards to the ISSB and TCFD standards.
Transition Plans will be read by different stakeholders and used for different purposes than financial reports.
Aligning sustainability disclosures with financial reporting structures creates a risk of hardwiring disclosure practices that are not suited to transition.
As an example, EU banks' financial reporting of credit exposures by industry sector follows a system of exposure classes that lacks the granularity needed to assess financed emissions, stranding risks, or the transition progress of a bank or its clients (the classes are listed in the Pillar 3 disclosures template for "EU CRB-D: Concentration of exposures by industry" and include generic headings such as "Mining and quarrying", "Manufacturing", "Electricity, gas, steam and air conditioning supply", and "Transport and Storage").
While there will be improvements to these disclosures as a result of the European Banking Authority's new ESG disclosure standard, this example highlights the problem of using a template designed for financial or economic decision making for decisions that also require impact materiality.
We understand there are benefits in aligning templates and allowing financial and sustainability data to map to each other, but in some cases sustainability disclosures will need to go further or have their own structure.

Materiality

a. The guidance is useful in supporting effective disclosure and is sufficiently detailed.

b. The guidance is useful in supporting effective disclosure but lacks sufficient detail.
c. The guidance is not useful in supporting effective disclosure.
d. Don't know

If b) or c)): Please explain why you gave that answer: [Free Text]

Not useful.

We disagree with the proposal to treat materiality in the same way in transition plans as in general purpose financial reporting.

Net zero transition requires a double materiality logic that includes the impact of the entity on the outside world, which is the only meaningful perspective to manage environmental impacts of company´s operations (and with this, the transition risks inherent in the company´s operations or portfolio – in case of financial institutions) and effectively achieve decarbonisation outcomes in the real world. We refer to the Finance Watch report "The problem lies in the net" for the perspective on decarbonisation objectives in transition planning (https://www.finance-watch.org/publication/report-the-problem-lies-in-the-net-making-finance-contribute-to-a-net-zero-economy/).

Transition plans have different users and uses from financial reports; for example, they are used by investors with ESG mandates who need to assess the reporting entity's impact on the environment, as well as policymakers, regulators and citizens who are concerned more broadly with net zero transition and not only with financial decisions related to the reporting entity.

An approach that includes both financial and impact materiality is essential if transition plans are to support a timely shift to net zero. It is also necessary if entities are to properly consider their impacts on nature and society as part of a Just Transition, as well as their contributions to resilience and adaptation.

We note that the TPT expects to use ISSB standards as a basis for transition plan disclosures.

The proposed text in ISSB's Exposure Draft IFRS S1 is based primarily around the risks and opportunities to enterprise value (Objective 1), with the impacts on people and planet given a very subordinate role (Objective 6c), and only if relevant for the primary users of financial information - essentially a single materiality approach. In the EU, by contrast, EFRAG's draft ESRS 1 requires risks, opportunities and impacts to be considered together in a double materiality approach.

Several respondents to the ISSB's 2022 consultation on IFRS S1 shared our concern that a single materiality approach could miss the wider purpose of transition plans. One large European bank with a substantial portfolio of fossil fuel assets put it well in its ISSB consultation response:

"Most companies will conclude that their own Scope 3 emissions are 'not material' and certainly not a threat to enterprise value. Broadly diversified investors, however, need this information to mitigate the systemic risk of climate change, regardless of how emissions might impact individual emitters. ... Systemic risk is a collective action problem, where the whole is greater than the sum of its parts. ... A company's impacts to nature, for example, will not always create foreseeable risk to that company, but may exacerbate the systemic risk of nature loss, which affects all companies. The complexity and severity of this systemic risk is entirely lost by placing enterprise value – as opposed to biosphere integrity - at the center of concern."

We would add that the information is not only material for investors but also for government, industry and other stakeholders.

The ISSB is expected to confirm a single materiality approach in June, in line with IFRS's narrow mandate to serve the primary users of financial information, i.e. investors and creditors. The ESRS, by contrast, were designed for a broader set of stakeholders. As transition plans would also be used by a broader set of stakeholders that includes users concerned with climate impact, we ask that the TPT make an explicit commitment to include impact materiality alongside financial materiality by adopting the language in EFRAG ESRS 1 para 2 that entities disclose "all the material information regarding impacts, risks and opportunities in relation to environmental, social, and governance matters". Sections 3.3 and 3.4 of the draft EFRS 1 also contain useful language in this regard.

Incorporation of interdependent issues such as social impacts, nature and adaptation

a. The guidance is useful in supporting effective disclosure and is sufficiently detailed.
b. The guidance is useful in supporting effective disclosure but lacks sufficient detail.
c. The guidance is not useful in supporting effective disclosure.
d. Don't know

If b) or c): Please explain why you gave that answer: [Free Text]

Covered above

Treatment of Uncertainty

a. The guidance is useful in supporting effective disclosure and is sufficiently detailed.
b. The guidance is useful in supporting effective disclosure but lacks sufficient detail.
c. The guidance is not useful in supporting effective disclosure.
d. Don't know

If b) or c): Please explain why you gave that answer: [Free Text]

a. We support the use of estimates where data is unavailable under the condition that such estimates are clearly described and explained and assumptions and methodologies are disclosed, as stated in the Guidance. This removes an argument not to disclose absolute Scope 3 emissions. The disclosure of uncertainties, assumptions and methodologies will help to build confidence in the estimates used.

In addition, a stipulation should be added that when sustainability statements include or are related to financial data and assumptions, such data and assumptions shall be consistent to the extent possible with the corresponding financial data and assumptions used in the financial statements.

The Framework: Overall

In the TPT Disclosure Framework we set out recommendations for entities to report against
five elements and 19 sub-elements of a transition plan. Do you agree with the overall framework? Please note that there will be a chance to provide feedback on the disclosure
recommendations for individual sub-elements.

a) Yes, I agree with the overall framework.
b) Yes, I broadly agree with the overall framework, but I have comments or suggestions.
c) No, I do not agree with the overall framework.

If b) or c): Please explain why you gave that answer: [Free Text]

[ref page 14 Disclosure Framework]

b. We broadly support the framework. However, more attention should be given to clearly separating disclosures of carbon credits from the disclosed GHG emissions and the climate targets. Companies should always disclose separately carbon credits used as offsets for their GHG emissions or as a means to reach their GHG emission reduction targets, as well as explain the role of carbon credits in their climate change mitigation policy and objectives. Carbon offsetting outside of the value chain

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should **never** be accounted for in the net-zero effort of companies nor in the determination of whether they have achieved their net-zero targets (refer to the Finance Watch report "The problem lies in the net", page 14). For the carbon credits within company´s own operations, the requirements should include explanation of how the risk of non-permanence is managed.
Further, it could be strengthened by giving more visibility to the need to terminate or decommission climate-harming activities that cannot transition. Choosing the best approach and timeline to achieve this, while protecting the interests of shareholders and other stakeholders and respecting climate-safe transition pathways, should be a central theme for transition plans that involve such activities.

The Framework: User Feedback
In the TPT Disclosure Framework we provide disclosure recommendations aimed to assist
entities to disclose credible, useful, and consistent transition plans. If you regard yourself as a user of transition plans, please assess the extent to which you expect disclosures in line with our recommendations to be useful for informing your decisions:
Very useful Useful Not useful Don't know

[ref page 15-25 Disclosure Framework]

1.1 Objectives and Priorities
Useful.
The objectives should also include a statement of ambition that is capable of being compared with other entities. For example, this might be a statement of which climate scenario is being targeted, a reference to a credible sector pathway consistent with limiting warming to 1.5°C with no or limited overshoot, or "an explanation of how the undertaking's targets are compatible with the limiting of global warming to 1.5°C in line with the Paris Agreement" (language from EFRAG ESRS E1 1-1, para 15a).

The climate objectives should always be based on the adopted classification of sustainable activities such as the EU Taxonomy (refer to the report "The problem lies in the net", page 15-16). In particular, in the climate dimension, the objectives should always refer to climate neutrality by 2050 or earlier.

The objectives should refer to the entity's impacts, as well as its risks and opportunities.

The reference to "reducing its own emissions" should be reworded to remove any ambiguity over whether scope 3 emissions are included (they should be).

There should not be the option to exclude scopes; all scopes should be included, using estimates if necessary.

We draw attention to other aspects of transition planning in section 1-1 of EFRAG's ESRS E1 Climate Change, including the treatment of locked-in GHG emissions from the undertaking's key assets and products and plans for future Taxonomy alignment (revenues, CapEx and CapEx plans).

1.2 Business model implications

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Implementation Strategy
2.1 Business Planning and Operations
2.2 Products and Services
2.3 Policies and Conditions
2.4 Financial Planning
2.5 Sensitivity Analysis

Not useful.

While we agree with the need to state critical assumptions, we are concerned that the sensitivity analysis could be a loophole used to justify delaying action until others in the supply chain have transitioned, for example oil & gas companies could state an assumption that consumer demand for fossil fuels will not reduce in line with a 1.5C scenario and weaken their targets accordingly, or banks could state an assumption that oil & gas companies will still require the same level of financing, and so on.

We do not have a specific proposal to address this but hope the guidance can be tightened so that this sub-element does not become a greenwashing tool.

Engagement Strategy
3.1 Engagement with Value Chain

Useful.

Disclosures about engagement with value chain could be extended to include references to sustainability due diligence and the reporting entity's escalation strategy.

For financial institutions, engagement disclosures should refer to product design (e.g. the use of climate covenants and pricing) and stewardship activities (including escalation and eventual exit). We refer to the Finance Watch report "The problem lies in the net", pages 33-37, for detailed explanations.

3.2 Engagement with Industry
3.3 Engagement with Government, Public Sector and Civil Society
Metrics and Targets
4.1 Governance, Business and Operational Metrics and Targets
4.2 Financial Metrics and Targets
4.3 GHG emissions Metrics and Targets

Very useful.

We strongly support the proposal to require absolute gross GHG emissions reduction targets for Scopes 1, 2 and 3.

If gross and net emissions are disclosed together, gross emissions should be given at least equal prominence.

It would help interoperability and quality if the guidance on emissions metrics and targets can be aligned with the guidance in EFRAG's ESRS E1 Climate change, see in particular section 1-4.

4.4. Carbon Credits

Useful.

Carbon credits for avoided emissions should be excluded. Carbon removal technologies that do not yet exist at scale should also be excluded.

We refer to our response to question "The Framework: Overall" above.

Governance

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5.1 Board Oversight and Reporting
5.2 Roles, Responsibility and Accountability

Useful.
We support a mandatory requirement for assurance of transition plans, in order to increase confidence and comparability.

5.3 Culture
5.4 Incentives and Renumeration
5.5 Skills, Competencies and Training

The Framework: Additional comments

Are there any other comments that you would like to provide on the TPT Disclosure Framework? (Optional) [Free Text]

To support international alignment and the goal of producing a gold standard for transition plans, we suggest that the eventual draft UK standard be subject to a gap analysis with EFRAG's draft European Sustainable Reporting Standards. This would enable any shortfalls and misalignments to be rectified on the UK side and the burden on reporting entities with both an EU and UK presence kept to a minimum. It would also help to avoid that any weaknesses inherited from the emerging ISSB framework, particularly in the integration of impact materiality and development of impact-related disclosures, can be corrected, and overall would contribute to a levelling-up of international standards.

The Guidance: Additional comments

Are there any other comments that you would like to provide on the TPT Implementation Guidance? [Free Text]

Overall Feedback

Is there any additional information that you would like

For transition plans to serve as a key building block for delivering a net zero future, the relatively narrow definitions of primary users and materiality that underpin ISSB disclosure standards and general purpose financial reporting will need to be broadened to meet the needs of the diverse set of stakeholders that will use transition plans. We urge the TPT, as it considers how best to build on the ISSB framework, to do so by incorporating ESRS definitions, which would meet those needs and at the same time increase inter-operability.

We look forward to commenting on the sector-specific guidance later in the year in relation to the financial sector, including on the role of prudential transition plans for banks, among other things.