Principles for Responsible Investment

DRAFT POSITION PAPER

PROTOTYPE CLIMATE AND GENERAL DISCLOSURE REQUIREMENTS DEVELOPED BY THE TECHNICAL READINESS WORKING GROUP (TRWG) FOR CONSIDERATION BY THE INTERNATIONAL SUSTAINABILITY STANDARDS BOARD (ISSB)

February 2022

PRI Association
Registered office: 5th floor, 25 Camperdown Street
London, UK, E1 8DZ Company no. 7207947
T: +44 (0) 20 3714 3220 W: www.unpri.org E:info@unpri.org

UN environment programme finance initiative
United Nations Global Compact
An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

INTRODUCTION

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI is now a not-for-profit company with over 4,300 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with approximately US $120 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

The PRI's Driving Meaningful Data programme is a key PRI Blueprint target and works on the types of data, sources and reporting frameworks needed to support responsible investors. This work includes ensuring consistent data across all the various units and entities, as well as addressing gaps identified in the Driving Meaningful Data Framework. This requires collaboration with others across the financial and corporate sectors as well as standard setters, policy makers and regulators. The PRI has an important role in working with our signatories to provide a clear signal on their data needs, how they aid decision-making and understanding their contribution towards sustainability objectives.

On 3 November 2021, the IFRS Foundation announced the establishment of the International Sustainability Standards Board (ISSB) at COP26.

The ISSB will develop IFRS Sustainability Disclosure Standards, including disclosure requirements that address companies' impacts on sustainability matters relevant to assessing enterprise value and making investment decisions. The future IFRS Sustainability Disclosure Standard aim to enable companies to provide comprehensive sustainability information for the global financial markets.

This draft paper provides an analysis of the two prototype standards developed by the Technical Readiness Working Group (TRWG), which were published for consideration by the ISSB early November 2021. The paper will serve as the basis for further discussion with PRI's signatories on the developments regarding the ISSB.

By providing recommendations on how the work of the TRWG could be further improved, the paper aims to inform the development of the IFRS Sustainability Disclosure Standards as the ISSB moves forward and considers the prototypes as part of its initial work programme and proposals for standards.

The analysis and recommendations set out in this paper were shared with and reflect input of members of the PRI Investor Corporate Reporting Reference Group. We are now calling on all signatories to share their views and feedback on the position paper.

The PRI has previously provided views and recommendations on international sustainability reporting standard setting through consultation responses and public statements.

For more information, contact:

René van Merrienboer

Acting Director, Sustainable Markets

rene.van-merrienboer@unpri.org

Susanne Dräger

Senior Specialist, Sustainability Reporting

susanne.draeger@unpri.org

SUMMARY AND KEY RECOMMENDATIONS

The PRI welcomes the publication of the prototypes developed by the Technical Readiness Working Group and provides the following analysis and recommendations to inform further development of the Sustainability Disclosure Standards led by the ISSB.

GENERAL REQUIREMENTS FOR DISCLOSURE OF SUSTAINABILITY-RELATED FINANCIAL INFORMATION PROTOTYPE

The general prototype standard sets draft requirements on sustainability-related financial disclosure of all sustainability-related matters in an issuers' general-purpose financial report. This should help improve the amount of decision-useful, comparable information available to investors on some sustainability-related matters, which his highly welcomed by the PRI. Nonetheless, based on our analysis we find that the following elements can be improved.

Materiality

Overall, the PRI prefers approaches to sustainability reporting that address both financial materiality and sustainability performance as the basis for standardisation. Sustainability reporting standards should evolve to respond to the needs of investors, which increasingly includes information enabling them to fully assess and interpret a company's sustainability performance and alignment in the context of long-term sustainability goals and thresholds.

Further, the PRI advocates for the fullest possible consideration of ESG risks and opportunities, recognising:

- sustainability issues may influence a company's financial performance and value over the short, medium and long-term;
- company impacts on key economic, environmental and social systems may have financial implications for a company, sector, or portfolio;
- as real economy sustainability policy develops at a rapid pace, alignment or significant misalignment with policy objectives and/or supervisory expectations are increasingly understood as financially relevant.

In terms of the prototype standard, the PRI recommends to:

- Require preparers to report the results of their materiality assessment – why data is <u>and</u> is not included in the assessment. This will ensure verifiability of the data, in particular for completeness and neutrality of data, and the comparability across investors' portfolios, through consistency of data.
- Provide clear guidance on the minimum requirements to conduct a materiality assessment, building on the wealth of components already listed in the standard. This should include clarifying whether a higher-level assessment of sustainability-related matters is required before management considers data requirements for each matter and require an assessment of materiality along a preparer's supply chain.

Interoperability

Interoperability is typically understood as information being collected which can support disclosure under one or more reporting regime – allowing for comparability of data across jurisdictions. Interoperability is a key concern for investors to ensure consistency and comparability of data. A key factor that distinguishes regimes is the materiality lens applied – whether financial materiality or sustainability performance.

The prototype standard adopts what is termed a 'building block' approach, which aims to allow jurisdictions to go further or accommodate for specific requirements, while retaining a common set of reporting requirements. In this context, the prototype standard is intended to play the role of defining a common set of requirements – to set a global baseline for reporting – whether that is based on financial materiality or double materiality. However, to ensure interoperability in this environment, would require close coordination between the ISSB and regional standard setters.

The PRI welcomes the exchange between the TRWG and regional standard setting and policy initiatives on corporate sustainability reporting and:

- Encourages the ISSB to continue engaging local regulators and standard setters to ensure interoperability of sustainability reporting standards and policies for the benefit of comparability and limitation of reporting and assessment burden.
- Equally, encourages local regulators and standard setters to engage closely with the ISSB.

Presentation of disclosure requirements

The prototype standard requires multiple strands of data from preparers. However, there is no recommendations or guidance on activity indicators, nor how this data should be linked together into a cohesive set in the general-purpose reports. The prototype implies that it will be on the issuer to decide how best to present this information.

The PRI recommends to:

- Specify the activity indicators reporting requirement, clarifying whether they should be reported across industries and/or unique to each industry.
- Provide guidance on the presentation of disclosure obligations, in particular a systematic approach to assessing financial impact.
- Clarify how to assess and present results of trade-offs and aggregation between different sustainability-related risks and opportunities.

Implementation

The prototype standard prioritises flexibility in implementation of the boundaries – both reporting boundaries and time period - and the expansion of matter-specific standards, which has started with a climate prototype.

The primary impact of the standard's current approach on boundaries is on comparability of reporting outputs across preparers, which risks consistency of the data. By setting the default to the financial accounting boundary, there may be gaps in the overall assessments along supply chains, unless: (i) it is explicitly required as part of a materiality assessment; and/or (ii) a specific aspect is required in

metrics/targets defined by a matter-specific standard. It is also left to the preparer to define its short, medium and long term.

Each sustainability matters will have a standard that complements the general standard, which matter-specific data required in each to reflect the unique requirements of each. This requires a common framework that accommodates for differences in the matters.

The PRI recommends to:

- Set minimum definitions of each time period.
- Set assessment and disclosure requirements on issuer's supply chain.
- Clarify whether disclosure is required on business units and/or activities.
- Include equal weight on assessment of opportunities and of risks, starting with the materiality assessment. This could include a section on opportunities, that mimics the current section on risk management to identify and enhance opportunities.
- Include a fourth category of data on context-specific metrics that needs to be reported by preparers (e.g. location(s) of operating entities). Specific requirements for this class of metrics can be identified through the matter-specific standards.
- Clarify how to assess trade-offs and aggregation between different sustainability-related risks and opportunities.

CLIMATE-RELATED DISCLOSURES PROTOTYPE

Cross-sector climate disclosures

This prototype concerns the identification, measurement and disclosure of climate-related risks and opportunities to which an issuer is exposed. It aims to help users to assess how these matters affect the reporting entity's financial position, performance, future cash flows and strategic response to climate-related risks and opportunities.

We welcome the strong alignment with the TCFD guidance documents.

However, we encourage the ISSB to consider the following recommendations:

- Implementation: provide static and forward-looking implementation examples for each of the seven cross cutting categories of metrics, to help companies better account for sector and jurisdiction specificities.
- Physical risks: further develop recommendations on physical risks from climate change to better capture companies' exposure to these risks, and how this is assessed and considered in companies' business interruption plans.
- Strategy: introduce disclosure recommendations capturing alignment of the strategy and business model with the objectives of the Paris Agreement to better capture companies' resilience to uncertain and rapidly changing environmental policy across jurisdictions.

- Metrics:
  - Introduce disclosure recommendations that capture material activity- and sector-specific emissions. These would allow investors to better compare entities performing those activities, and preparers to better link sustainability risks to financial considerations such as asset impairment assumptions.
  - Introduce quantitative disclosure recommendations capturing how remuneration for each relevant executive is impacted by performance against each target. This would help investors to assess the credibility of these targets.
- Targets: introduce disclosure recommendations that capture Scope 1, 2 and 3 emissions reduction targets to support investors in their own target-setting and in meeting regulatory and voluntary reporting requirements.
- Publish a common template for the disclosure of targets to improve comparability of these targets across companies. PRI supports the template proposed by London Stock Exchange Group referenced in annex 1 below.

Sector-specific disclosures

The sector-specific approach to climate disclosures can be strengthened **for all sectors** by:

- removing references to jurisdiction-specific standards and regulations;
- ensuring that all sector-specific metrics are directly relevant to climate change, and
- clarifying links with the seven cross-industry climate metrics.
- To provide enhanced clarity to preparers, the ISSB should consider publishing implementation examples of cross-industry metrics and corresponding sector-specific metrics for relevant sectors and jurisdictions.

The sector-specific approach to climate disclosures can be strengthened **for the financial sector** by:

- adapting proposed requirements to focus on climate as opposed to all ESG issues, and to focus on policies and results with fewer requirements on underlying processes. This would allow for disclosures on the factors most relevant to enterprise value, and closer alignment with jurisdiction-level ESG disclosure requirements for investors such as the EU Regulation on sustainability-related disclosures in the financial services sector (SFDR)1.

[1] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector

ANALYSIS

The analysis provides further details on the prototype standards and its implications on users.

GENERAL REQUIREMENTS FOR DISCLOSURE OF SUSTAINABILITY-RELATED FINANCIAL INFORMATION

The Prototype standard sets draft requirements on sustainability-related financial disclosure of all sustainability-related matters in an issuers' general purpose financial report. It sets an overarching conceptual basis for the disclosure requirements, general guidance on disclosure on all sustainability-related matters and guidance on the reporting channel. It has been structured to follow accounting standard IAS 1 ('Presentation of Financial Statements').

A framework on disclosure for financially-material sustainability-related matters

The general standard has the following features:

- Investors are among the primary audience ('primary users'[2]) of the standard.
- Focus of disclosure is on what will influence primary users' decisions [10]. This is interpreted as information that will have an influence on enterprise value [3].
- Disclosure requirements are aligned with the TCFD guidance's general structure on governance, strategy, risk management and metrics and targets [24-47].
- Requires reporting of comparative information to enable comparability with previous periods [48].
- Requires annual reporting in line with issuers' financial account's reporting period [51].
- Requires the sustainability-related reporting to be interlinked with the issuers' financial reporting [21; 65]. Irrespective of whether the statements are completed using the IFRS Accounting Standards or other regional standards [64].
- Requires that the reporting channel must be in the issuer's general purpose financial reporting. The prototype suggests the management commentary, but provides issuers some flexibility [57].
- Requires a statement of compliance with the standard [88], in line with reporting obligations on financial statements.

Implications for primary users

The general prototype standard should help improve the amount of decision-useful, comparable information available to investors on some sustainability-related matters.

Implementing and reporting on a materiality assessment

Information on sustainability-related risks and opportunities are considered 'material', if "omitting, misstating or obscuring information that could reasonably be expected to influence decisions that the primary users of general purpose financial reports [including investors] make on the basis of those reports" [10]. The prototype interprets that information is material if affects the primary users'

[2] The primary users include (existing and potential) investors, lenders and other creditors.

assessment of an issuer's enterprise value[3]. However, the protype clarifies that this could include "impacts on society and the environment" (i.e. externalities) if this "could reasonably be expected to affect the entity's future cash flows" [12-a] or include events that have "a low likelihood but high potential impact on the entity's future cash flows" [12-b].

The protype does, however, allow the materiality assessment to be 'dynamic' as it recognises that some risks and opportunities may only have an influence in the short, medium and/or long term [3]. As this may change over time, the issuer is required to re-assess materiality in each reporting period that an issuer's circumstance(s) changes [14]. It also allows flexibility to the issuer to include information that goes beyond the standard, if its management deems the information material for its primary users – to better understand the potential implications on the issuers financial position [18], identified in the needs of its primary users [Appendix C], required by local laws and regulations [Appendix C].

The materiality assessment is the key to deciding what the issuer will disclose in its sustainability-related financial disclosure – it is the process through which an issuer will decide what to report on and what not to report on. This is especially important as an issuer is not required to report on any information required by the IFRS Sustainability Disclosure general standard or matter-specific standards unless it is deemed material.

However, **there is no guidance in the standard on how a materiality assessment should be conducted**, this includes no "quantitative threshold for materiality" [13][4]. The reasoning given is that materiality is considered "entity-specific" [13] and so the decision should be on the issuer's management. The points in the box (below) outline the information and/or assessments the standard recognises the management may need to consider in a materiality assessment[5]. However, a more formal structure and/or systematic approach is not outlined in the standard - for example, using a series of filters to consider risks and/or opportunities[6].

Points the issuer's management should consider in its materiality assessment:

- Account for the issuer's circumstances of the issuer in a materiality assessment [14].
- Conduct assessment annually – as materiality may change over time, the standard requires the assessment is undertaken at "each reporting date" [14].
- Assess each individual pieces of information (policy, metric, target etc.) required by the IFRS Sustainability Disclosure Standard [17] – this means that if management deems information as not material, they do not have to disclose it.
- Consider whether additional information is required that goes beyond the requirements of the standard [18] if it would inform users assessment of enterprise value[7].

[3] More specifically, it is defined as information that would "assist users [including investors] in predicting the value, timing and certainty of the entity's future cash flows, over the short, medium and long term and therefore their enterprise value" [IN3].

[4] This is in line with the approach the IFRS has taken on its financial accounting standards.

[5] Note, it is unclear if a higher-level assessment of sustainability-related matters is also required.

[6] These filters could include: an initial filter on short term financial materiality; followed by medium and (then) long term materiality where (direct) externalities are internalised; and finally where the influence of the company's operations on society creates a feedback into the company's operations.

[7] The information referenced in this point does not refer to other sustainability related matters.

- Assess whether “activities, interactions and relationships with parties outside the reporting entity’s boundary” affects the issuer’s enterprise value [20].
- Describe the process for identifying material sustainability-related risks and opportunities [29-a].
- Assess whether information on possible future events are material, including: (i) the effects on enterprise value, including in the long term [75]; and (ii) the full range of possible outcomes[8] and the likelihood of the possible outcomes [75].
- Conduct an assessment of common information needs of its primary users [Appendix C].

There is also **no formal requirement for management to report on the results of the materiality assessment**. Primary users would only have the information reported on what management deems material to extrapolate what it does not deem material (i.e. by omission). The only situation noted in the standard where information must be reported on why it is excluded is if information is material to the entity but “local laws or regulations prohibit the entity from disclosing that information” [67].

Implications for primary users

Adversely affects comparability of data across investees. The standard has been developed to improve comparability of sustainability-related data, which requires that issuers must be consistent in the application of the standard (although not necessarily identical) [Appendix D]. The standard’s current approach to ensure flexibility could risk consistency (and therefore comparability). Without guidance on how to conduct a materiality assessment, issuers could report different sets of information by interpreting the materiality assessment differently. In addition, without an explanation on why information is not deemed material, investors may not be able to make the necessary adjustments across issuers in integrating the sustainability data into their decision-making; or may rely on limited data to engage with an issuer on their sustainability performance.

Adversely affects verifiability of the data from investees. Without the requirement to report on the results of the materiality assessment explaining why factors have been deemed material or immaterial, there is no way for investors and auditors to be able to verify if information is a ‘faithful representation’. According to the prototype [Appendix D], in order to meet this requirement, the data must be ‘complete’ (i.e. include all material information) and ‘neutral’ (i.e. no bias). As materiality would be entirely at the discretion of management, users would not be able to verify whether all material information has been reported, nor if there are any biases in the management’s assessment of materiality.

Potential interoperability with other instruments

The prototype allows issuers to report on other reporting standards and/or obligations alongside the IFRS Sustainability Disclosure Standards, as long as it does not obscure the (material) information reported in compliance with the standard [58; Appendix C]. However, it does not allow issuers to report “less information than the information required by the standards, even if local laws and regulations permit it to do so” [Appendix C].

[8] Term is not formally defined in the standard, but implied to refer to long term effects on future cash flow.

In principle, this means that the standard creates a common set of requirements for issuers that already follow the IFRS accounting standards[9] and allows local instruments (i.e. standards/regulations) to go further – i.e. a 'building blocks' approach. Where jurisdictions follow a double-materiality approach, such as the EU, the standard would not prevent issuers from reporting on information in the general purpose financial reporting statement to reflect these requirements[10].

However, there *may* be gaps in the resulting corporate disclosure under two situations (for each issuer):

A. If an issue is not deemed (financially) material[11]; or
B. If an issue is deemed financially material, but only specific parts and/or metrics are (financially) material[12].

In both situations, unless jurisdictions are explicit about reporting on all information requirements listed by the IFRS across all aspects of the standard – including specific requirements under governance, strategy, risk management and metrics and targets – issuers will only be required to report on the specific pieces of information defined by the instrument (e.g. metrics). Alternatively, if reporting obligations are not aligned, it could add to the reporting burden on issuers (and investors processing their data) as they may have to report on different pieces of information in separate reporting channels.

Implications for primary users

The nuances around interoperability of the IFRS Sustainability Disclosure Standard with local instruments **could risk comparability of data across jurisdictions**. In jurisdictions where investors expect to see corporate sustainability-related data following a double-materiality approach[13], investors may find gaps in reporting:

- within their jurisdiction, if local obligations on corporate level disclosure does not cover all aspects of the IFRS Sustainability Disclosure Standard's requirements (point A above); and
- outside their jurisdiction, where investees within their portfolio are not required to report on the same issues and/or metrics (point A or B above).

The larger question on comparability of data across jurisdictions needs more time and information on local approaches and implementation of future IFRS Sustainability Disclosure Standard. This is only a high-level assessment based on the prototype standard and no specific instrument to cross-test interoperability.

---

[9] This includes issuers in at least 140 jurisdictions and does not prevent other jurisdictions from adopting similar standards.

[10] In some situations, impacts on the environment/society may already be reported under the ISSB if the data has an influence on enterprise value [IN3].

[11] For example, if production has an adverse impact on biodiversity and does not change expected future cash flows

[12] For example, the right to a living wage is deemed financially material but the right to non-discrimination is not deemed financially material.

[13] Where outcome-level data may be important for investors' objectives, strategies and/or reporting obligations.

Guidance on presentation of disclosure requirements beyond the TCFD guidance

There are multiple strands of data required in issuers' disclosure, with no recommendations on how to link the data together into a cohesive set with links to the issuer's financial statements [2-b; 21; 61; 63]. The prototype implies that it will be on the issuer to bring this together, potentially through the management accounts.

Broadly, the types of information expected from the disclosure can be split into:

- Qualitative information on: (i) governance [25]; (ii) strategy [28; 30; 31; 33]; (iii) risk management [35]; and (iv) uncertainty on outcomes [77]; and
- Quantitative information on: (i) progress on plans to address sustainability-related risks and opportunities [31-c]; (ii) financial implications of the sustainability-related risks and opportunities [32]; (iii) issue-specific metrics, organised into cross-industry (defined in each thematic standard), industry-based (defined in each thematic standard) and activity metrics (undefined to date); (iv) targets (defined in each thematic standard); and (v) the issuer's KPIs (linked to metrics and targets) .

Generally, these information requests follow the structure of reporting obligations from the TCFD guidance, with three key overarching differences[14]:

1. The breakdown of 'metrics' that will be defined by each matter-specific standard into three categories[15] – this provides common (cross-industry) and industry-specific data that should help investors collect relevant, decision-useful information. However, there is (so far) no guidance on a comprehensive list of activity indicators to normalise the first two sets of data in the general prototype (nor in the climate prototype). These activity metrics could be cross-industry (e.g. number of employees) and at industry-specific level (e.g. number of cars produced in the automotive sector).
2. The presentation of financial information – the level of detail on disclosure set by the prototype standard [32] and the financial resilience of the entity [33] goes beyond TCFD guidance. Although there is some guidance on disclosure requirements on reporting resilience[16], the same level of detail has not been provided on (more generally) reporting financial impact. The only requirement set by the prototype is the need to link this information clearly with data in the financial statements [2-b; 21; 61; 63] [17]. For example, issuers could report a line-by-line assessment of potential changes to each of the three financial statements, or only report on elements management deems as relevant.
3. The presentation of multiple sustainability-related risks and opportunities – there are high-level requirements in the standard to disclose on:

[14] A more thorough breakdown is provided for the prototype climate standard in the next section.

[15] Protype standard more broadly references three types of metrics [37]: (i) the metrics to be defined by matter-specific standards (cross-industry, industry-based and activity metrics); (ii) targets set by the issuer's governance body(-ies); (iii) other key performance indicators set by the issuer's governance body(-ies) towards the targets.

[16] Disclosure requirements on resilience [33] include: (i) how the analysis was undertaken; (ii) reporting boundary; (iii) time horizon; and (iv) results of the analysis, which should at least include the results of the analysis.

[17] Where the financial statements are not completed following IFRS Accounting Standards, the standard used will additionally need to be reported [64].

a. Trade-offs between sustainability-related matters: requires issuers to report on trade-offs [22-b]. Specific guidance is provided on the need for governance systems to assess these trade-offs [25-e] and to report on the trade-offs considered in decision-making [31-d]. However, no guidance is provided on how these should be assessed, whether on a financial basis (as not all factors can be monetised) or against metrics already defined by each standard, or reported.
b. Aggregation of sustainability-related matters: the standard leaves it to the issuer to decide how to report on aggregating different sustainability-related matters, without reducing the understandability of what the standard defines as material information [70]. Once again, there is no guidance on how this could be implemented.

Implications for primary users

A lack of clarity on the presentation of information – particularly on financial impacts – risks the understandability of the information disclosed, and thereby influences the usefulness of the data. This will likely be an acute concern for investors in the initial reporting cycles, before good practice is recognised.

Issues like reporting on trade-offs may, however, take more time to define, especially as metrics are still in development for many of the sustainability-related matters outside of climate. Alternatively, issuers and/or investors may need to use the financial impacts as a common medium to assess and translate the impacts.

The breadth of new information that will be produced could also add to the analytical burden on investors (and/or its service providers), in particular, in initial reporting cycles. This could be exacerbated by delays to integration of the data from a lack of consistency as: (i) good practice is defined; and (ii) if there are delays/no guidance provided by the ISSB on activity indicators.

Implementation of (reporting and temporal) boundaries

The primary reporting boundary of the prototype is the same as the issuer's financial statement [19]. As a default, this implies disclosure will be at entity-level, but would allow for a more granular scale of reporting, if requested in a metric/target defined by the matter-specific IFRS Sustainability Disclosure Standard (e.g. climate). Although, it is unclear whether this would include a breakdown by business units/activities if an issuer's financial statements are already reported at this scale[18].

The boundary is extended to reporting along the supply chain only when there is a material influence on enterprise value from outside this boundary [20]. Where a material influence is identified, issuers are required to report on [30]: (i) "a description of the current and anticipated effects" on this chain; and (ii) where along the value chain, the risks or opportunities are "concentrated"[19]. However, a comprehensive process on assessing risks and opportunities is missing, in part as a framework on assessing materiality has not been specified. This risks issuers only considering disclosure on risks

[18] For example, following IFRS 8 on operating segments, listed companies can disclose information about their operating segments, products and services, the geographical areas etc.

[19] Examples in the standard of the scale include: geography, facilities, types of assets, inputs, outputs or distribution channels.

and opportunities along the supply chain, when required by a matter-specific IFRS Sustainability Disclosure Standard (e.g. Scope 3 emissions in the climate standard).

The prototype has no formal definition of time horizons – short, medium and long term – as it states their definitions are based on multiple factors unique to the context of the issuer [29]. However, the standard does require the issuer to report on: (i) how it defines the three time periods [28-b]; (ii) how these “definitions are linked to the entity’s strategic planning horizons and capital allocation plans” [28-b]; and (iii) the expected time horizon over which each sustainability-related risk or opportunity would have a financial effect [28-c]. In addition to the prototype’s reasoning of issuer’s context, an additional argument in favour of this approach is as time horizons for different issues may also play an important role – where the definition of the long term would differ drastically for climate change versus human rights.

Implications for primary users

The primary impact of the standard’s current approach on boundaries is on **comparability of reporting outputs across issuers**. This risks consistency in data as the standard leaves a level of flexibility to issuers on defining both the time period and the reporting boundary.

On time period, the standard ensures a level of transparency by requiring issuers to report on their definitions. However, it will be on investors (and data service providers) to make the necessary adjustments to normalise data – adding to the complexity of the data processing required. In the extreme, an issuer could define their time horizons in a way that could reduce the understandability of their reporting on risks and risk management, while (potentially) remaining compliant with the prototype. For example, by defining the long term as 3 years, a variety of risks may be bundled into this time horizon.

On reporting boundaries, although there are concerns about consistency of data, a greater concern of the current approach is on **potential risks to completeness of the data**. By setting the default to the financial accounting boundary, there may be **gaps in the overall assessments along supply chains**, unless: (i) it is explicitly required as part of a materiality assessment; and/or (ii) a specific aspect is required in metrics/targets defined by a matter-specific standard. This could especially be of concern for sustainability-related matters outside of climate, where the metrics may not be as well defined – see key message 6.

The default view on entity-level reporting could also be of concern for investors on **potential risks to completeness of data within business units and/or activities**. In some jurisdictions, like the EU, this more granular reporting is required in order to meet reporting obligations, but these obligations are not universal. This may, however, be a larger concern when considering issues outside of climate, which may require more granular information to be decision useful for investors – see key message 6.

Applying the general standard directly to other sustainability-related matters

Sustainability-related matters that have been recognised by the ISSB in its general standard includes (in no particular order): climate, labour practices, human rights and community relations, water use and discharge; and biodiversity [IN7; Appendix B].

Where a matter-specific standard is yet to be developed, the prototype recommends management “use its judgement in disclosing information that will meet the objectives” of informing investors (and

other primary users) [71][20]. When considering these sustainability-related matters an implicit pecking order is given on sources of information: (i) the general standard [72]; (ii) one of the ISSB's other standards, that relates to a similar and related risk and opportunity [72]; and (iii) other external standards [73].

In principle, this general standard – which follows the general TCFD structure – must be equally fit-for-purpose for climate and for all the other potential sustainability-related matters. Based on a preliminary assessment of the prototype, the following gaps have been identified:

- **The protype standard is (by design) not expected to set disclosure requirements on some/all sustainability-related matters** – the focus on enterprise value will implicitly exclude some/all of the data relevant to some of the sustainability-related matters that are only externalities to a company. In part, this assessment of the boundary will depend on the issuer's context and the management's materiality assessment. However, issues like biodiversity and some aspects of human rights are more likely to be seen as externalities, and therefore likely to be considered outside the scope of the disclosure requirements by issuers.
- **Greater focus on risks than opportunities** – opportunities are referenced throughout the standard alongside risks, but there is a stronger emphasis on systems and management of risks (over opportunities). This stems from adopting the TCFD approach, where on climate, a lot of focus has historically been on risks. However, reporting on sustainability-related matters going forward (including on climate) may need to consider opportunities with at least equal measure.
- **Need for context-specific data points** – although there are three layers of metrics in the protype standard, a fourth layer may be necessary. Most environmental and social matters outside of climate require data to contextualise the risks and/or opportunities, including data: at a more granular scale than entity-level; geolocation of a specific asset; local/national legal context on human rights issues; baseline information on local/national context etc. This data would need to be disclosed alongside the remaining metrics in order for the cross-industry and industry-specific metrics to be interpreted correctly by the primary users.
- **Lack of clarity on assessing other matters in combination** – as reported above, there is no guidance on how issuers should assess and report on trade-offs between matters and aggregation of these matters.

Implications for primary users

Overall, the implications on investors lay in the completeness of the data. As the prototype standard creates the framework for a global 'baseline' on sustainability-related data, applying the standard to sustainability-related matters outside of climate could have several consequences on data for investors:

- Gaps in disclosure on some sustainability-related matters that may be decision-useful for investors – **concerns of completeness of the data**, as there may be potential gaps in decision-useful data for some investors that use the information in their decision-making process.

[20] The standard describes three principles for the information to be decision-useful for investors [71]: relevance, faithful representation and neutrality. These concepts have been used throughout the prototype.

- Greater focus on risks than opportunities – could **influence the faithful representation of the data, in particular the neutrality of the data** as the information could weight risks over opportunities. Depending on the investors' strategy, this could mean that investors do not have access to decision-useful information; and (at worst) could inadvertently influence investment decisions due to the availability of the information.
- Need for context-specific data points – could **influence relevance of the data, reducing the decision-usefulness of the disclosure data**.
- Lack of clarity on assessing other matters in combination – could **influence usefulness of the data as it would influence the understandability** of the data that is reported, the **consistency** of the data and (potentially) the **relevance** of this information.

CLIMATE-RELATED DISCLOSURES PROTOTYPE

This prototype provides recommended disclosures for the identification, measurement and disclosure of climate-related risks and opportunities to which an issuer is exposed. It will help reporting users to assess how these matters affect the reporting entity's financial position, performance, future cash flows and strategic response to climate-related risks and opportunities.

As for the general standard, the following sections provide key messages on the climate-related disclosures prototype, implications for signatories and (draft) recommendations on next steps.

Alignment with the TCFD guidance

Two sections of the prototype are fully aligned with TCFD guidance:

- **Governance:** the same disclosure recommendations are proposed for oversight, responsibilities, reporting lines, remuneration
- **Risk management:** the same disclosure recommendations are proposed on processes for identifying, assessing and managing climate risks

The remaining three sections are mostly aligned with TCFD guidance:

- **Strategy:**
  - Describing material climate-related risks and opportunities.
  - Effects on the business strategy, where in the value chain these are concentrated, how this impacts management's strategy and decision-making.
  - Impact on the entity's financial position now and in the future.
  - Climate-related scenario analysis (understandably, guidance on scenario analysis in the general standard is less specific).
- **Metrics:** the TCFD guidance's seven core metrics have been directly adopted within the prototype. Understandably, cross-industry metrics to be disclosed are not yet developed in the general standard.
- **Targets:** the same underlying disclosure recommendations on targets as in TCFD guidance are proposed:
  - Baseline, methodology, interim targets, metrics and performance.
  - The prototype goes further than TCFD guidance by asking whether each target is science-based, validated by a third party and derived using a sectoral decarbonisation approach.

Implications for primary users

We welcome alignment in these areas, as it will allow for meaningful and comparable sustainability disclosures from companies.

Areas for improvement regarding cross-sector recommendations

a. Implementation

Disclosure of cross-industry metrics

The prototype provides seven cross-industry metrics to be disclose by all companies [13]. While this is aligned with TCFD guidance and promotes comparability in reporting, investors would benefit from the introduction of detailed guidance for companies on implementing these disclosures.

Implications for primary users

Companies operate in industry-specific contexts and are subject to varying standards and regulatory requirements. As a result, some may struggle to implement these recommendations in a way that produces harmonised and decision-useful information for investors. Companies would benefit from static and forward-looking implementation examples for each of the seven cross-industry categories of metrics. The ISSB could reference and further develop the recent guidance that was published by the TCFD. To better ensure international operability, it would be important that these implementation examples have a clear and direct reference to major international disclosure legislation, such as the EU Climate Taxonomy Delegated Act under the climate-related opportunities category.

With this guidance, companies could effectively disclose cross-industry metrics in a way that appropriately accounts for entity-, sector- and country-specific nuances, without compromising the quality or comparability of their reporting.

b. Physical risks

Exposure and management information

The prototype asks companies to disclose information that enables an understanding of how each significant climate-related risk is monitored, managed and mitigated, including relevant policies [11], and the amount and percentage of assets or business activities vulnerable to physical risks [13-c]. This is aligned with TCFD guidance.

Implications for primary users

Investors would benefit from better data from companies on their exposure to physical risks and how these are being managed, as reflected in a recent publication by the Institutional Investors Group on Climate Change (IIGCC).[21] By providing enhanced guidance with respect to disclosures on physical risks, the ISSB could help companies to fill a significant outstanding data gap for investors.

In particular, investors would benefit from more widespread reporting of metrics pertaining to:

- Asset location data of company's main facilities and leading suppliers.

[21] Institutional Investors Group on Climate Change, Building Resilience to a Changing Climate: Investor Expectations of Companies on Physical Risks and Opportunities

- How physical climate risk is assessed and considered in company's business interruption plans.
- Financial losses from extreme weather events.
- Anticipated future financial impacts based on the results of climate scenario analysis.

c. Strategy

Alignment with the Paris Agreement

- The TCFD's Guidance on Metrics, Targets and Transition Plans recommends that companies disclose the amount of capital expenditure, financing or investment deployed toward climate-related risks and opportunities.[22] This is also a recommendation within the TRWG Climate-related Disclosures Prototype [13-e].
- However, the TCFD's guidance also recommends that companies disclose 'actions and activities to support the transition, including GHG emissions reduction targets and planned changes to businesses and strategy'.[23]
- Similarly, the EFRAG Climate standard prototype asks companies to describe plans to ensure that the business model and strategy are compatible with the transition to limiting of global warming to 1.5°C.[24]

The TRWG Climate-related Disclosures Prototype takes a different approach – recommended disclosures only focus on how companies are responding to their identified climate-related risks and opportunities.

Implications for primary users

Investors need information on company alignment with a 1.5°C world, to assess companies' resilience to uncertain and rapidly changing environmental policy across jurisdictions, rather than just resilience to risks and opportunities anticipated by companies at a given point in time.

Information on company alignment with the Paris Agreement is also needed by investors to fulfil their requirements under the following voluntary initiatives:

- Investor Climate Action Plans (ICAPS) Expectations Ladder[25] and Climate Action 100+[26], in order to measure own alignment with a 1.5°C world and identify companies for priority engagement.
- Note: for CA100+ companies are asked for commitments to align Capital Expenditure with the Paris Agreement and share of future Capital Expenditure aligned with a 1.5°C scenario.

---

[22] Task Force on Climate-Related Financial Disclosures, Guidance on Metrics, Targets and Transition Plans, page 33.

[23] Ibid, page 43

[24] European Financial Reporting Advisory Group, Climate standard prototype, page 12.

[25] The Investor Agenda, Investor Climate Action Plans (ICAPs) Expectations Ladder, page 4.

[26] Climate Action 100+, Net Zero Company Benchmark, page 13.

d. Metrics

Geographic- and activity-specific emissions

The TCFD's Guidance on Metrics, Targets and Transition Plans recommends that companies disclose disaggregated climate metrics by geographic area and business unit where useful.[27]

Similarly, the EFRAG Climate standard prototype asks companies to disclose GHG emissions breakdowns per country (Scopes 1 & 2 of the 5-10 biggest countries contributions) and per business unit, market segment or economic activities.[28]

The TRWG Climate-related Disclosures Prototype asks for Scope 1-3 GHG emissions and intensity [13-a] but does not contain the above recommendation.

Furthermore, the prototype asks companies to disclose how relevant performance metrics against climate-related targets are incorporated into remuneration policies [4-f], as well as the proportion of executive management remuneration affected by climate-related considerations in the current period (expressed in a percentage, weighting, description, or amount in reporting currency) [13-g]. This is aligned with TCFD guidance but could be further strengthened to benefit investors.

Implications for primary users

The lack of proposed disclosure recommendations on material geographic- and activity-specific metrics is a material gap because investors may need reporting at economic activity level for comparability between entities performing those activities, and at country level to understand systemic risk arising from varying policy objectives across jurisdictions. Activity-level disclosures would also make it easier for preparers to link sustainability risks to financial considerations such as asset impairment assumptions.

Furthermore, in the coming years investors will need to contend with a proliferation of different jurisdiction-specific taxonomies and, more importantly, taxonomy methodologies. The ISSB has the opportunity to push for a global harmonisation of approaches and boost comparability of reporting across geographies by introducing a standardised approach to activity-level disclosures.

Finally, the proposed metrics on climate-related remuneration would allow companies to disclose an aggregated percentage metric across all executives, and across all targets and other climate-related considerations. Investors could better assess the credibility of climate targets if they knew how remuneration for each relevant executive was impacted by performance against each target.

e. Targets

Forward-looking emissions reduction targets

---

[27] Task Force on Climate-Related Financial Disclosures, Guidance on Metrics, Targets and Transition Plans, page 13.

[28] European Financial Reporting Advisory Group, Climate standard prototype, page 46.

The TCFD's guidance on Metrics, Targets and Transition Plans[29] (cf. p32) and EFRAG's Climate standard prototype[30] recommend that companies disclose forward-looking targets covering Scope 1-3 absolute GHG emissions as well as GHG intensities.

The TRWG climate prototype proposes disclosure recommendations for Scope 1-3 GHG emissions and intensity, but only proposes recommendations to disclose emissions reduction targets at sector-specific level for high-emissions industries such as extractives and minerals processing and resource transformation.

Implications for primary users

Investors need information on these emissions reduction targets from all portfolio companies, regardless of sector, for: a) setting and tracking performance against their own targets; b) regulatory reporting; c) use of increasingly prevalent taxonomy approaches; and d) understanding of future improvements in resilience of investee companies.

Company emissions reduction targets are also needed by investors to fulfil their requirements under the following voluntary initiatives:

- UN-convened Net-Zero Asset Owner Alliance and Climate Action 100+, in order to measure own alignment with a 1.5*C world and identify companies for priority engagement.
- Science-based targets initiative, in order to use all three proposed approaches to target-setting for financial institutions: Sectoral Decarbonization Approach, Portfolio Coverage Approach and Temperature Rating Approach.

Comparability with voluntary initiatives

The prototype does not contain disclosure recommendations on Just Transition and climate policy engagement.

Implications for primary users

While this is not a gap against TCFD guidance, investor-led initiatives have indicated the need to go further in these two areas.

Just Transition

- Climate Action 100+ will be introducing a new set of Just Transition metrics in its next assessment cycle.[31]
- Note that the EFRAG Climate standard prototype asks firms to describe the potential effects of developments in climate policies, markets, technology evolutions or reputation perception in terms of social costs.[32]

Climate policy engagement

---

[29] Task Force on Climate-Related Financial Disclosures, Guidance on Metrics, Targets and Transition Plans, page 32.

[30] European Financial Reporting Advisory Group, Climate standard prototype, page 28.

[31] Climate Action 100+, 2020 Progress Report, page 12.

[32] European Financial Reporting Advisory Group, Climate standard prototype, page 53.

- ICAPS asks for a commitment from companies to conduct all lobbying in line with the Paris Agreement and only be a member of trade associations that do the same.[33]
- CA 100+ asks for the above, plus company disclosure on the process to ensure that trade associations lobby in accordance with the Paris Agreement, and on their specific lobbying position and activities.[34]

Industry-based metrics

The sector-specific approach can be strengthened for all sectors by:

- Removing references to jurisdiction-specific standards (e.g. ENERGY STAR program and Association of Home Appliance Manufacturers for consumer goods) and jurisdiction-specific. Referencing globally used standards and regulations could help facilitate jurisdiction-level adoption.
- Linking sector-specific climate metrics to the list of seven cross-industry metrics, such that it is clear to entities how the former complement and reinforce the latter. This guidance could then be used by reporting entities to inform narrative and location of disclosures. This would facilitate preparation of sustainability reports as well as analysis by investors.
- Publishing implementation examples of cross industry-metrics and corresponding sector-specific metrics for relevant sectors and jurisdictions. Examples could reference regional standards and regulations that would be applicable and why. This would provide increased clarity to preparers across all jurisdictions and lead to more decision-useful reporting.
- Only including sector-specific metrics that are relevant to climate change mitigation and adaptation. Metrics on topics such as water management, waste management and air quality are frequently included for individual sectors. This will unnecessarily increase the reporting burden for preparers and complicate analysis for users.

The sector-specific approach can be strengthened for the financial sector by:

- Ensuring that these recommendations focus on the incorporation of climate-related factors, as opposed to all ESG factors, in investment management and advisory.
- Adapting recommendations to focus on factors that are: a) most relevant for enterprise value; and b) reflected in jurisdiction-level ESG disclosure regulation for investors.
    - These being **policies and results**, with more high-level reporting recommendations on granular processes and responsibilities underlying these.

Rationale

- Focusing climate-related disclosures on the incorporation of all ESG-related factors in investment management and advisory would unnecessarily increase the reporting burden for preparers and lead to less clear and decision-useful information for users.

[33] The Investor Agenda, Investor Climate Action Plans (ICAPs) Expectations Ladder, page 4.

[34] Climate Action 100+, Net Zero Company Benchmark, page 15.

- Furthermore, proposed disclosure recommendations for asset managers and insurers would go beyond jurisdiction-level requirements such as SFDR on process-related disclosures with little value for external assessments of enterprise value. **For example:**
  - Proposed recommendations on ESG integration (applicable to asset managers and insurers) cover how ESG factors influence the entity's views on time horizon and traditional fundamental factors, approach to incorporating ESG factors in selecting external fund managers, and differences in approach by asset class or ESG integration style employed – none of which are present in SFDR. This is even the case in France's implementations of SFDR[35], which is relatively stringent.
  - Similarly, proposed recommendations on voting and engagement (applicable to asset managers but not insurers) include much further detail on engagement approach, staff involvement and escalation process than SFDR, and even France's implementation of SFDR.

[35] See French implementation of SFDR: Décret n° 2021-663 du 27 mai 2021 pris en application de l'article L. 533-22-1 du code monétaire et financier - Légifrance (legifrance.gouv.fr)

ANNEX 1: TARGET SETTING TEMPLATE[36]

GHG target disclosure template		
Target ID		
Overall number of active GHG emissions targets:		Include interim targets in the count
Target number:		
Target type:		Indicate whether this is aboslute or relative
Date the target was set:		
Target Information		
Scope(s) covered		For scope 2 emissions, indicate if calculations are location- or market-based. For scope 3 emissions, indicate the GHG protocol categories that are covered.
Organisational boundary		Describe the accounting boundary (e.g. operational/equity) on which the target is set. This should be consistent with its historical emissions and production/sales disclosures. Note additional exclusions if any (e.g. regional basis).
Percentage of in-scope emissions covered by the target :		
Base year:	Base year emissions:	For intensity targets, provide activity measure (e.g. tCO2e/Mwh or tCO2e/tonne of cementitious product)
Target year:	Target year projected emissions:	
Targeted reduction from base year (%)		
Targeted reduction from current year (%)	Current emissions:	Please indicate the most current year for which emissions data is available.
Target Methodology		
Verified by a independent third party?		If yes, please indicate the name of the independent third party that verified the target
Name of the reference scenario used		
Source describing how the percentage of in-scope emissions covered by the target has been calculated		Please indicate the title(s) of publicly available documents and relevant page numbers where information can be found.
Source describing transition plan outlining how this target will be met.		Please indicate the title(s) of publicly available documents and relevant page numbers where information can be found.
For Scope 3 targets, source describing the methodology used to calculate the Scope 3 emissions covered by the target.		
Indicate the % of the target to be achieved through offsets and provide a source specifying their type and the offset provider.		
For intensity targets, source describing the methodology used to calculate the carbon intensity.		

[36] The PRI is grateful to the London Stock Exchange Group for providing the basis for this template.