EFAMA
European Fund and Asset Management Association

CONSULTATION RESPONSE

Brussels, 29 July 2022

EFAMA RESPONSE TO THE ISSB' EXPOSURE DRAFTS ON SUSTAINABLE REPORTING STANDARDS

The European Fund and Asset Management Association (EFAMA) welcomes the opportunity to respond to the ISSB consultation on the Exposure Drafts on "General Requirements for Disclosure of Sustainability Related Financial Information" (IFRS S1) and on "Climate-Related Disclosures" (IFRS S2).

In this comment letter, we wish to highlight some of the key challenges faced by asset managers in reporting sustainability-related Information and share a few recommendations which we hope will be helpful for the ISSB while finalizing the standards.

As a preliminary remark, we broadly support the work of the ISSB, and the effort made by providing those first set of standards as we are convinced that it will play a crucial role in coordinating different actors involved globally and in guaranteeing a better-aligned implementation of sustainable reporting worldwide. Although we welcome this initiative, we strongly encourage the ISSB to work closely with the European Financial Reporting Advisory Group (EFRAG), especially regarding materiality impact and the overall alignment with ESRS, including the extension to other ESG topics, as well as further collaboration with the Global Reporting Initiative (GRI) which has set standards adopted already worldwide.

Climate risk is a global issue for investors, and they would be best served if regulators and standard-setting bodies take a coordinated approach across jurisdictions to facilitate high-quality, comparable climate-related disclosures.

General observations on the Exposure Drafts

The growing demand for sustainability reporting standards has translated into a fragmented landscape of different public and private frameworks, each addressing different needs and presenting different approaches or specifications. As a result, the information provided by companies lack comparability and suitability for the wide variety of users they seek to satisfy. This limits the ability of investors to integrate sustainability considerations into their decisions. At the same time, compliance with the transparency rules introduced for asset managers is significantly challenged by the lack of appropriate data to meet these requirements not only due to sequencing issues but largely due to the absence of a global standard to report sustainability-related information. We, therefore, support initiatives that seek to establish reporting standards that aim to promote consistency and comparability. Most importantly, we support and appreciate initiatives that build on existing, well-established standards (e.g. TCFD, SASB, GRI, etc.).

Furthermore, given the upcoming implementation of the Corporate Sustainability Reporting Directive (CSRD), the European legislation will become more demanding in terms of sustainability reporting. All the spectrum of ESG will have to be covered, reflecting the importance of the double materiality principle and guaranteeing the alignment with major pieces of legislation in sustainable finance (i.e. Sustainable Finance Disclosure Regulation, Taxonomy), and with all the transparency requirements that EU financial market participants are facing (e.g. the principal adverse impacts of SFDR). To this extent, and in our below recommendations to the ISSB, we encourage the ISSB to work closely with EFRAG in particular to ensure the compatibility of the reporting standards and to provide useable information for asset managers to fulfil their EU obligations, in particular with respect to the principal adverse impact indicators.

Considering also the need to ensure a better flow of information across the sustainable investment chain – including SMEs – and the need for high-quality data, EFAMA welcomes the ISSB initiative to develop IFRS Sustainability Disclosure Standards, comprehending disclosure requirements that facilitate the understanding of companies' impacts on sustainability and ensure informed investment decisions.

Regarding the ISSB's Exposure drafts, which will represent a progress in fostering the vision of comparable investor-relevant sustainability-related information, we generally support the following points:

- **The alignment with the Task Force on Climate-related Financial Disclosures (TCFD) and the inclusion of Scope 3 emissions as a cross-industry metric category for disclosure by all entities subject to materiality** – we support aligning the standards with the TCFD as those recommendations are widely used across the largest capital markets, with 2600 users globally and some regulators have already begun mandating TCFD-aligned reporting (i.e. European Union, Brazil, United Kingdom, Hong Kong, Japan, New Zealand, Singapore and Switzerland). In addition, we welcome also that paragraph 21 in the Climate Exposure Draft proposes that an entity is required to disclose its absolute GHG emissions for the period, measured in accordance with the GHG Protocol for its scope 1-3 emissions.

- **Creating the path to a global baseline** – considering the global nature of the markets, it is important to be able to compare the sustainability risks and opportunities across different jurisdictions. Hence, we fully endorse the ambition of the ISSB to conduct institutional and technical standard-setting work to establish the core elements of a global baseline. Acknowledging that the idea of a global baseline has been welcomed also by the G7[1], G20[2], the International Organization of Securities Commissions[3] (IOSCO) and the Financial Stability Board[4], we support international collaboration in the development of standards as it is essential to create a consistent disclosure system across different markets. The current consultation on the ISSB's proposed standards is the right opportunity for jurisdictions to develop high-quality standards for capital markets.

Recommendations on the Exposure Drafts IFRS 1 and IFRS 2

Notwithstanding our overall support for the ISSB's attempt at creating a global baseline for sustainable reporting, we believe – from an investor's perspective - that the ISSB's general approach and the Exposure

---

[1] https://www.gov.uk/government/publications/g7-finance-ministers-meeting-june-2021-communique/g7-finance-ministers-and-central-bank-governors-communique

[2] https://www.mef.gov.it/inevidenza/2021/00045/12.Communique-Third-G20-FMCBG-meeting-9-10-July-2021.pdf

[3] https://www.iosco.org/news/pdf/IOSCONEWS638.pdf

[4] https://www.fsb.org/2021/07/report-on-promoting-climate-related-disclosures/

Drafts would benefit from improvements in the following areas:

#1 Interoperability between standards and double materiality as criteria

To ensure interoperability of the ISSB's proposed standards with EFRAG's ESRS, it is important that the standards embed both financial materiality and impact materiality. Whilst impact is specifically referred to in how an entity's sustainability risks and opportunities can arise, this has been made in the context of the impact affecting the entity's performance and then eventually the entity's enterprise value (therefore circling back to financial materiality). However, it is crucial that standards acknowledge that companies consider the complete picture of their external impacts, including those that do not have any potential consequences on the organisation.

Furthermore, focusing only on financial materiality can represent a risk in addressing and identifying correctly sustainable issues at company level and for the financial industry. We remark that financial materiality of sustainable issues evolves rapidly, also in function of the regulatory changes. Thus, it is crucial that standards take into account these fast progressions, at market and legislative level, to provide to investors the clearest view possible on the potential impact that an investment can have not just on the economy, but also on people and the planet. Only in this way, we can guarantee that the investor is provided with adequate amount information to make a considerate decision.

Against this background, we welcome the collaboration between the ISSB and the Global Reporting Initiative (GRI), given that latter's expertise in developing standards to enable organizations to understand and report on their impacts on the economy, environment and people. In addition, we strongly encourage further collaboration with EFRAG, so that companies compliant with ESRS would be considered compliant also with the IFRS standards, and we support also collaboration with the Jurisdictional Working Group as it represents a key initiative to drive the necessary interoperability within standards. Considering also the European legislative framework, namely the SFDR, the EU Green Taxonomy, and the recently adopted CSRD, which entails the use of the double materiality approach, we believe that the ISSB should consider extending the financial materiality perspective, in order to include also the impact one.

#2 Including some mandatory indicators to allow the alignment with SFDR PAIs

We believe that, beyond materiality, there is a set of minimum sustainability impact indicators – covering all ESG topics - that should be integrated in priority in the reporting cross industry standards. Such indicators should at least be aligned with the full set of principal adverse impact (PAI) indicators as per the EU regulatory disclosure obligations for financial products and financial market participants (SFDR regulation). This has been done by EFRAG and we urge the ISSB to align theirs standards in this respect. This information from reporting entities is key to the asset managers, and the financial industry in general, to fulfil their EU obligations, and drive capital flows towards issuers.

#3 Reaching common ground in the disclosure requirements for information on material risks and opportunities from the perspective of enterprise value creation

As asset managers, we serve as fiduciaries on behalf of our end investors, henceforth we are required to focus the investment analysis on material ESG matters which may impact the value of investments and ultimately returns. We support that the Exposure Drafts proposed by the ISSB will allow capturing material sustainability-related financial information that could reasonably be expected to influence primary users' assessments of an entity's enterprise value ".

#4 Providing clarity on the use of "significant" and "material"

The Exposure Drafts state that entities are required to identify and disclose information about all the significant, material sustainability-related risks and opportunities. We acknowledge that the “Basis for Conclusions” provided by ISSB explains that the significance of risks and opportunities is entity-specific and determined according to the entity’s risk management processes and informed by the entity’s strategy, objectives and risk appetite. Significant risks and opportunities are therefore those that an entity prioritises for management responses. However, we believe that this explanation is not sufficient, and we call for clarity of the terms “significant” and “material”. It is otherwise unclear whether a different process is required to assess significance and materiality. Furthermore, we recommend that the terminology to identify risks and opportunities, after being clarified and defined, be made consistent across the standard (e.g., the use of “significant” and “material”).

#5 Core content: General Requirements Paragraph 22(b), 22(c) and 22(d)

Concerning Question 4 – Core content (paragraphs 11-35) of the Exposure Draft IFRS S1, the information required would represent core aspects of the way in which an entity operates and this approach reflects also the well-established work of the TCFD. We suggest that from a long-term investment perspective, it is important to highlight how an entity’s financial position may be affected by material sustainability risks and opportunities over many years. Consequently, the ISSB might consider:

- General Requirements Paragraph 22(b): We recommend extending the timeframe for disclosures for which there is a significant risk of material adjustments to the financial statements from “within the next financial year” to “within the next three years.”

- General Requirements Paragraphs 22(c) and 22(d): Where the drafts reference changes to expected performance “over time,” we suggest specifying instead “over the short, medium and long term.”

In relation to short, medium and long term, we acknowledge the flexibility that the Exposure Draft provides for firms to define these timeframes. However, to promote further comparability, we suggest that the ISSB provides practical guidance on how firms should be defining these with consideration of the definitions proposed by EFRAG in their standards.

#6 Additional guidance on connected information and entity-specific disclosures and metrics

The Exposure Draft (paragraphs 43) proposes that an entity shall describe the relationships between different pieces of information, requiring connecting narrative information on governance, strategy and risk management. For example, to allow users of general-purpose financial reporting to assess connections in information, an entity might need to explain the effect or likely effect of its strategy on its financial statements or financial plans, or on metrics and targets used to measure progress against performance. Therefore, we encourage the ISSB to offer further guidance to disclosing entities on the practicalities of reporting connected information. The Exposure Drafts offer two examples which do not provide full insight into which sustainability or financial impacts should or should not be considered when disclosing connected information. The ISSB may wish to make clear that such connected information should focus only on connecting sustainability topics to the financials where the entity has stated it believes those sustainability topics to be material. Where relevant, such connected information should include a discussion of trade-offs and how they were weighed.

In addition, considering that the ISSB envisages the possibility of individual issuers determining their own metrics and disclosures, it is crucial that such entity-specific metrics do not result in confusion for investors. Therefore, cases in which such metrics could qualify as “adjusted” versions of those asked by the ISSB reporting standards should be accompanied by satisfactory disclosure explaining the adjustments made and the rationale for these adjustments.

#7 Additional guidance on Climate related transition plans

As noted in the consultation, disclosing an entity's transition plan towards a lower-carbon economy is important for enabling users of general-purpose financial reporting to assess the entity's current and planned responses to the climate-related risks and opportunities that can reasonably be expected to affect its enterprise value. Furthermore, we believe that transparency on plans will contribute towards addressing greenwashing risks. Therefore, it is key that entities provide an adequate explanation as to why no such plan exists including the timeframe when the entity expects to develop such a plan particularly if material climate risks and opportunities have been identified.

Additionally, we would recommend the following points:

- 'Absolute GHG emission reduction actions' should be a mandatory feature of the transition plan.
- Transition plan content should clearly refer to emissions reduction targets without using carbon offsets. We believe that the ISSB should draw on EFRAG's work and make a distinction between 'emissions reduction targets' and 'GHG neutrality targets'. To that extent, we believe that 'carbon offsets' should not be counted in 'GHG emissions reduction targets'.
- Climate-related scenario should be aligned with commonly known international agreements and frameworks.

EFAMA

ABOUT EFAMA

EFAMA, the voice of the European investment management industry, represents 27 member associations, 58 corporate members and 26 associate members. At end Q4 2021, total net assets of European investment funds reached EUR 21.9 trillion. These assets were managed by more than 35,000 UCITS (Undertakings for Collective Investments in Transferable Securities) and more than 30,000 AIFs (Alternative Investment Funds). At the end of Q3 2021, assets managed by European asset managers as investment funds and discretionary mandates amounted to an estimated EUR 31.3 trillion.

More information is available at www.efama.org

Contacts:

Chiara Chiodo
Regulatory Policy Advisor – ESG & Stewardship
chiara.chiodo@efama.org | +32 2 5482666