28 July 2022

# THE EUROPEAN BANKING FEDERATION ON THE ISSB CLIMATE EXPOSURE DRAFT (IFRS S2)

We are pleased to provide a response to the ISSB consultation questions on the IFRS S2 Climate-related Disclosures (Climate Exposure Draft).

We will be pleased to respond any question you may have or provide more details.

## Question 1 - Objectives

**(b) Does the objective focus on the information that would enable users of general purpose financial reporting to assess the effects of climate-related risks and opportunities on enterprise value?**

There could be challenges with linking long-term climate-related risks (particularly physical risks) to current the financial position, performance and cash flows, since some types of climate risk are longer-term than banks' current financial positions. This means that linkage between scenario analysis and current financial impact are often subject to assumptions and estimates.

## Question 5- Transition plans and carbon offsets

**(c) Do you think the proposed carbon offset disclosures will enable users of general purpose financial reporting to understand an entity's approach to reducing emissions, the role played by carbon offsets and the credibility of those carbon offsets? Why or why not? If not, what do you recommend and why?**

There should be more clarity and guidance on how firms should disclose carbon offsets. We think indeed that carbon offset disclosures will enable users to understand an entity's approach to reducing emissions. It can be an effective tool if future emissions will be avoided by the purchase and decommissioning of CO2-emission certificates or if emissions will be captured in nature or stored in the earth. Credibility can be achieved by the purchase and decommissioning of CO2-emission certificates or by external verification and certification schemes by means of certified carbon offsets. However, we have three concerns regarding the ISSB proposal.

First, we believe that carbon offsets should not be included within scope 1 ,2, and 3 carbon emission accounting. Carbon credits or other offsets should be fully removed from the disclosure of carbon footprint in order to give the real transparency that stakeholders are asking for. Otherwise, the false narrative that corporate emissions are falling while global emissions are rising will continue. ISSB and EFRAG are both aligned with GHG protocol on scope 1,2 and 3 inventory which does not include carbon offsets.

Second, we do not agree with the ISSB's proposal to allow the use of carbon offsets to define the level of GHG emissions reduction targets. All companies, whatever the jurisdiction, should disclose gross GHG emissions reduction targets, and carbon offsets separately, with a detailed split reporting of offsets procured from third parties and those self-produced by the company, as well as details of the different types of carbon offsets eventually used by the company (reduction, removals) and degree of permanency.

In our view, carbon offsets should only be included in the definition of net zero targets, as proposed by EFRAG. Transition plans should rely as little as possible on the 'offsetting' of GHG emissions in order to meet the targets. In general, 'offsetting' should only be accepted for GHG emission sources that do not have viable reduction alternatives due to technological or financial constraints.

Third, we do not agree that the carbon offset definition includes avoided emissions. We recommend that avoided emissions should be excluded from carbon offsets as their nature is completely different. They should be reported in a separate optional disclosure.

Also, clarity on the extent to which mitigating actions are included/quantified would be appreciated – e.g., when calculating enterprise value and impacts, should this be on a static basis, or with management action.

The ISSB should follow existing best-practice guidance in this regard, e.g., from the Voluntary Carbon Markets Integrity Initiative, to ensure consistency with wider industry activities".

## Question 7 – Climate resilience

**(b) The Exposure Draft proposes that if an entity is unable to perform climate related scenario analysis, that it can use alternative methods or techniques (for example, qualitative analysis, single-point forecasts, sensitivity analysis and stress tests) instead of scenario analysis to assess the climate resilience of its strategy.**

**(i) Do you agree with this proposal? Why or why not?**

Yes, we agree. There should indeed be a transition period/safe harbour for less mature elements of sustainability reporting, during which reporting can be provided on a "best effort" basis. Such a transition period would avoid confusion for users of disclosures and reduce liability risk for preparers.

## Question 9 – cross industry metric categories and GHG emissions

**The cross-industry requirements are intended to provide a common set of core, climate-related disclosures applicable across sectors and industries. Do you agree with the seven proposed cross-industry metric categories including their applicability across industries and business models and their usefulness in the assessment of enterprise value? Why or why not? If not, what do you suggest and why?**

**(d) Do you agree with the proposals that an entity be required to provide an aggregation of all seven greenhouse gases for Scope 1, Scope 2, and Scope 3—expressed in $CO_2$ equivalent; or should the disclosures on Scope 1, Scope 2 and Scope 3 emissions be disaggregated by constituent greenhouse gas (for example, disclosing methane ($CH_4$) separately from nitrous oxide ($NO_2$))?**

We agree on the proposal that an entity be required to provide an aggregation of all seven greenhouse gases for Scope 1, Scope 2, and Scope 3 as the aggregation is appropriate for financial institutions. In addition, we are supportive of the integration of the TCFD's cross-industry metrics categories, which provide a consistent framework. However, it makes sense that non-financial companies should disclose Scope 1, Scope 2 and Scope 3 emissions on a disaggregated basis, by constituent greenhouse gas, following for instance the focus of COP 26 on methane emissions.

**(e) Do you agree that entities should be required to separately disclose Scope 1 and Scope 2 emissions for:**

**(i) the consolidated entity; and**

**(ii) for any associates, joint ventures, unconsolidated subsidiaries and affiliates? Why or why not?**

We believe the scope of a reporting entity should be aligned with the general purpose financial reporting. While the ISSB proposal states that, in general, a reporting entity's boundary is the same for its sustainability-related disclosures as for its financial statements, in the climate-related exposure draft (IFRS S2) ISSB is proposing additional climate-related disclosures for a broader set of entities, i.e., a consolidated group would be required to disclose GHG emissions by associates and joint ventures separately from those by the consolidated group.

For those associates and joint ventures that are not under the direct control of the consolidated group there would be a high reliance on publicly available information that may not be reliable and/or comparable to satisfy the reporting requirements as laid out the in the exposure draft. Access to data remains a key barrier and challenge, in particular for financial institutions that are key users of information. We therefore encourage the ISSB to review this requirement.

**Q 11 – Industry based requirements**

**(d) Do you agree with the proposed industry-based disclosure requirements for financed and facilitated emissions, or would the cross-industry requirement to disclose Scope 3 emissions (which includes Category 15: Investments) facilitate adequate disclosure? Why or why not?**

The ISSB requires financial entities to report on both "financed emissions" (GHG emissions financed through loans and on-balance sheet investments) and "facilitated emissions" (off-balance sheet transactions such as underwriting, securitization and advisory services).

Further clarification about facilitated emissions requirement is needed, to avoid double counting and considering the lack of existing measurement methodologies for the moment.

The standard setters should be more explicit that financed emissions focus on an issuer's own balance sheet and should not include assets managed for third parties AUM, derivatives or trading book. If ultimately this information is required, the requirement should take into account the current lack of methodologies and provide an appropriate timeframe for its implementation.

**(h) Do you agree that an entity be required to use the GHG Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard to provide the proposed disclosures on financed emissions without the ISSB prescribing a more**

**specific methodology (such as that of the Partnership for Carbon Accounting Financials (PCAF) Global GHG Accounting & Reporting Standard for the Financial Industry)? If you don't agree, what methodology would you suggest and why?**

We encourage the ISSB to consider the current challenges associated with the availability of high quality data and lack of methodology for certain sectors and asset types, in particular for scope 3 financed emissions. Therefore, we recommend the introduction of a sector phase-in aligned to PCAF methodology, the Net Zero Banking Alliance timeline and a materiality-based approach for the disclosure of Scope 3 financed emissions.

We also encourage the ISSB to consider an incremental approach to sustainability-related metrics generally, whereby those at a mature stage of development are implemented first. In contrast, those metrics that are at an earlier stage of development, be introduced later as data availability improves in the market. An example of this would be internal carbon prices. While some financial institutions use them as a variable within internal climate scenario analysis exercises, it is not a metric firms are currently comfortable publishing for reasons related to confidence in data quality.

The definition of 'Scope 3 emissions' needs to specify if the reporting of non-financial companies should be for the full value chain or just tier 1 upstream and downstream. It also implies that the types of activities which are not directly mentioned are somehow exempt and do not need to be included in the reporting. This should be clarified.

It is also not clear whether emissions related to ICT activities, the hardware involved, and their resourcing (cobalt, lithium, other precious metals) are to be reported. According to recent reports, ICT activities alone are now more than 2% of global emissions and likely higher when value chains are fully accounted, although this may be too ambitious for reporting purposes.

Furthermore, to reduce the risk of misinterpretation and facilitate meaningful disclosure we would benefit from having a comprehensive set of illustrative examples setting out methodologies and calculations, e.g., for the calculation of financed emissions where the allocation of the emissions data is required at the subsidiary level; however, data may only be available at the consolidated level of a counterparty and not at the legal entity level of a counterparty.

For the financial sector, the ISSB standard should prescribe a more specific methodology to measure their scope 3 category 15 emissions, including a clear reference to PCAF, but also a prescriptive methodology to avoid multiple counting of GHG emissions when measuring the carbon footprint of a diversified portfolio.

**(I) In noting that the industry classifications are used to establish the applicability of the industry-based disclosure requirements, do you have any comments or suggestions on the industry descriptions that define the activities to which the requirements will apply? Why or why not? If not, what do you suggest and why?**

The use of the same definition of sector/industry for the Industry-based disclosure requirements under the different frameworks is needed to avoid unnecessary burden. ISSB has defined 77 sectors following SASB definition, which is too US centric and not appropriate for an international standard. Although the EFRAG has not issued the sector-specific standards yet (it intends to do so later), in its preliminary working papers it defined 44 sectors based on NACE codes. We strongly recommend the ISSB to collaborate with the SEC and the EFRAG and for the ISSB to produce a global baseline for sector/ industry or at least a correspondence table.

## Question 14 - Effective date

**Do you think that the effective date of the Exposure Draft should be earlier, later or the same as that of [draft] IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information? Why?**

Adoption should take place at the same time but there should be a phasing with qualitative disclosures ahead of quantitative disclosures. Firms should be encouraged to adopt the principle in IFRS 8 of "through the eyes of management" whereby different sustainability related risks and opportunities should be considered for disclosure consistent with the firms' strategy, risk appetite and management of specific sustainability risks and opportunities.

**(b) When the ISSB sets the effective date, how long does this need to be after a final Standard is issued? Please explain the reason for your answer including specific information about the preparation that will be required by entities applying the proposals in the Exposure Draft.**

Large companies and internationally active entities already have to report ESG information, not only derived from mandatory regulation but also because other stakeholders demand it. Therefore, the sooner there is an international common mandatory framework for everyone, the sooner there will be homogeneous and comparable information.

**(c) Do you think that entities could apply any of the disclosure requirements included in the Exposure Draft earlier than others? (For example, could disclosure requirements related to governance be applied earlier than those related to the resilience of an entity's strategy?) If so, which requirements could be applied earlier and do you believe that some requirements in the Exposure Draft should be required to be applied earlier than others**

We support the approach taken by TCFD.

Yes, there should be safe harbor provisions, in line with the SEC proposals, for less mature elements of sustainability reporting that require estimates, while data and methodologies are being improved. Even where data is available, significant development is needed in data capture and reporting capabilities/controls.

Another option when information is not available and to avoid estimates could be the "disclose or explain" in the case when just a part of the information is available, giving the opportunity to the reporters to develop the complete information as soon as possible.

The ISSB should explicitly recognize that some areas of reporting, e.g., scenario planning, will evolve over time. Consequently, having some self-attestation of where a company has, and has not, met the requirements — noting reasons why it has not been possible — may be a helpful addition. This will enable progress to be made, maintain internal and market pressure to iterate, whilst recognising challenges and risks.

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In addition, IFRS S1 and IFRS S2 should be published at the same time to avoid risk of fragmentation, and to establish a baseline standard for those jurisdictions that decide to look at ESG issues beyond climate.

## Question 15 - Digital reporting

**Do you have any comments or suggestions relating to the drafting of the Exposure Draft that would facilitate the development of a Taxonomy and digital reporting (for example, any particular disclosure requirements that could be difficult to tag digitally)?**

We believe that it is important to foster digital reporting but it should be phased in once data and reporting has started to mature.

We also believe that the digital reporting will increase the availability and comparability of information.

## Q 16 - Global baseline

**Are there any particular aspects of the proposals in the Exposure Draft that you believe would limit the ability of IFRS Sustainability Disclosure Standards to be used in this manner? If so, what aspects and why? What would you suggest instead and why?**

Yes.

1) Unless ISSB clarifies that impact, information is indeed relevant for investors to assess the enterprise value, the question of double materiality may be an issue for European companies in particular. Even if the constitution of the IFRS foundation prevents the ISSB from proposing double materiality, we believe that the ISSB may have some margin of maneuver to make the impacts on people, the planet and the economy clearer.
2) The reliance on industry-based SASB Standards may limit its application as a global baseline standard.
3) The scenario used by an entity to assess is resilience and targets should be based on the "latest international agreement on climate change", while the EFRAG refers to a 1.5-degree scenario.
4) We strongly encourage ISSB to co-design international sectoral standards with other standard setters, such as EFRAG to increase its acceptance as a global baseline standard.

It will be crucial for a global adoption and/or recognition of IFRS Sustainability Disclosure Standards to design an equivalence or substituted compliance regime for sustainability-related and climate-related disclosures so that they do not need to produce duplicate disclosures where the informational content is equivalent. For this to work, we underscore the importance of global alignment around common definitions.

## Q 17 - Other comments

**Do you have any other comments on the proposals set out in the Exposure Draft?**

**Timing of the reported information**

We support the ISSB proposal for a company to disclose sustainability-related information as part of its general-purpose financial reporting to ensure that financial statement information and sustainability-related disclosures can be considered together, highlighting interrelationships and connections between different types of risks and opportunities. As a consequence, the sustainability-related disclosures would be required to be published at the same time as the financial statements.

It's relevant to note that the information collected from third parties will have one year offset (the latest available information), and this should be permitted, otherwise this information would always be missing".

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## About EBF

The European Banking Federation is the voice of the European banking sector, bringing together national banking associations from across Europe. The federation is committed to a thriving European economy that is underpinned by a stable, secure, and inclusive financial ecosystem, and to a flourishing society where financing is available to fund the dreams of citizens, businesses and innovators everywhere.

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