UNEP FI Response to the IFRS/ISSB General Requirements Exposure Draft

July 2022

Introduction

UNEP FI has constructed this response based on its 30-year partnership between the UN and the global financial sector.

Founded in 1992, UNEP FI was the first organisation to engage the finance sector on sustainability and has played a pioneer role in un-packing the link between business and sustainability, driving the finance sector's capacity to manage sustainability issues as an integral part of business strategy and management.

As the UN network for the finance sector, we've established the world's foremost sustainability frameworks within the finance industry to address global environmental, social and governance (ESG) challenges. We incubated the Principles for Responsible Investment, now the world's leading proponent on responsible investment, and are facilitating implementation of UNEP FI's Principles for Responsible Banking and Principles for Sustainable Insurance, as well as the UN-convened net-zero alliances.

Today, we cultivate leadership and advance sustainable market practice with more than 400 financial institutions, with assets of more than US$80 trillion, headquartered in over 85 countries. UNEP FI supports implementation of global programmes at a regional level across Africa & the Middle East, Asia Pacific, Europe, Latin America & the Caribbean and North America.

Key Messages

UNEP FI commends the work of the ISSB in developing the General Requirements Exposure Draft ('GRED'). The standard being developed by the ISSB provides a unique opportunity to equip primary users of general purpose financial reporting with the full breadth of information that is useful to assess enterprise value as a basis for investment choices and decision-making.

In particular, we welcome:

- The ISSB's efforts to build upon a number of globally recognised market standards, namely the TCFD and SASB standards.
- The alignment sought between financial and sustainability disclosures, namely as regards scope and timing.
- The acknowledgment that enterprises need to consider all significant sustainability-related topics, including the interlinkages between these.
- The consideration of both cross-cutting and sector-specific sustainability issues.
- The recognition of both risk and opportunity factors.

We see scope for enhancement and seek to draw attention to:

- The currently ambiguous and potentially narrow definition of enterprise value and what might affect it (positively and negatively).
- The limited requirements and guidance on how to appropriately undertake some of the actions underlying the information that needs to be disclosed, in particular the identification of material issues, and the existence of increasingly consensual norms which could be drawn on to this end.
- The existence of a 'risk bias', with less attention devoted to the treatment of opportunities, which are equally important.
- The long and complex construction of the document, including repetition between the four sections, which as a result makes it difficult to identify exactly what entities should report.

In what follows, we expand further on these concerns and set out our recommendations in relation to them, responding to a selection of consultation questions posed by ISSB. This includes specific text suggestions; these are offered by way of illustration, for clarification purposes.

RESPONSE TO THE CONSULTATION

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Question 2-Objective (paragraphs 1-7)
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Question 4-Core content (paragraphs 11-35)
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Question 7-Fair presentation (paragraphs 45-55)
(b) Do you agree with the sources of guidance to identify sustainability-related risks and opportunities and related disclosures? If not, what sources should the entity be required to consider and why? Please explain how any alternative sources are consistent with the proposed objective of disclosing sustainability-related financial information in the Exposure Draft.
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Question 8-Materiality (paragraphs 56-62)
(a) Is the definition and application of materiality clear in the context of sustainability-related financial information? Why or why not?
(b) Do you consider that the proposed definition and application of materiality will capture the breadth of sustainability-related risks and opportunities relevant to the enterprise value of a specific entity, including over time? Why or why not?
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Response to consultation questions

Question 1-Overall approach
b) Do you agree that the proposed requirements set out in the Exposure Draft meet its proposed objective (paragraph 1)? Why or why not?

The objective of [draft] IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information is to require an entity to disclose information about its significant sustainability-related risks and opportunities that is useful to the primary users of general purpose financial reporting when they assess enterprise value and decide whether to provide resources to the entity.

The appropriateness of the overall approach is, in the first instance, a function of what is understood by enterprise value and how it can be (positively or negatively) affected. We find the GRED to be ambiguous on this point; while the Introduction speaks of *'an entity's ability to remain resilient',* Appendix A defines enterprise value as '*the sum of the value of the entity's equity (market capitalisation) and the value of the entity's net debt'.*

The former can be interpreted more broadly than the second; it considers an enterprise's health beyond its market value at a given moment in time. The two may or may not always be aligned.

The overall approach of the GRED may meet its objectives if the objective is narrowly centred on market value; the approach will only partly meet objectives if the objective is centred more broadly on an enterprise's health and resilience. To address the latter, additional disclosures and guidance are required, namely as regards core content and fair presentation (see responses to consultation questions 4, 7 and 8 below).

UNEP FI assumes and recommends that the second, broader objective is pursued, bearing in mind the growing spectrum of investor interests, the evolving policy and regulatory landscape, and the fact that, eventually, over-estimated enterprise health and resilience inevitably does translate into a loss of market value –the moment at which this happens can be sudden and is by and large unpredictable, as global crises remind us.

<u>UNEP FI's recommendation:</u>

Clarify the scope of enterprise value, and hence of objectives, that is being considered. Include a clear definition early on in the document, not just in Appendix A. If the narrower definition is retained, make it explicit and provide a clear explanation.

Question 2-Objective (paragraphs 1-7)

b) Is the **definition of 'sustainability-related financial information'** clear (see Appendix A)? Why or why not? If not, do you have any suggestions for improving the definition to make it clearer?

Sustainability-related financial information: *Information that gives insight into sustainability-related risks and opportunities that affect* ***enterprise value****, providing a sufficient basis for* ***users of general purpose financial reporting*** *to assess the resources and relationships on which an entity's* ***business model*** *and strategy for sustaining and developing that model depend.*

While the above definition of 'sustainability-related financial information' (taken from Appendix A) is clear, it's illustration in paragraph 6 is not. The language lacks clarity; items b) c) and d) are particularly difficult to follow, even more so for an international audience, and is not in alignment with what is outlined under 'Core Content', blurring the picture of what it is that organisations will be expected to disclose.

UNEP FI's recommendation:

Rewrite paragraph 6 to align it with the 'Content' section of the Standard.

Illustration:

6-Sustainability-related financial information is broader than information reported in the financial statements, as an entity's sustainability-related risks and opportunities arise from its dependencies and its impacts on the natural environment, the societies and the economies it is embedded in. As outlined in further detail in the section of this Standard on 'Core Content' sustainability-related financial information could include ~~information about~~:

- *(a) an entity's governance of sustainability-related risks and opportunities,*
- *(b) its strategy for addressing them;*
- *(c) the entity's corresponding management processes*
- *(d) the indicators, metrics and targets it uses and establishes to the same end*

~~(b) decisions made by the entity that could result in future inflows and outflows that have not yet met the criteria for recognition in the related financial statements;~~
~~(c) the entity's reputation, performance and prospects as a consequence of the actions it has undertaken, such as its relationships with people, the planet and the economy, and its impacts and dependencies on them; and~~
~~(d) the entity's development of knowledge-based assets.~~

Question 4-Core content (paragraphs 11-35) (a) Are the **disclosure objectives** for governance, strategy, risk management and metrics and targets clear and **appropriately defined**? Why or why not? (b) Are the **disclosure requirements** for governance, strategy, risk management and metrics and targets **appropriate to their stated disclosure objective**? Why or why not?

*(a) Are the **disclosure objectives** for governance, strategy, risk management and metrics and targets clear and **appropriately defined**? Why or why not?*

Overall, the disclosure objectives are clear and well defined, with the notable exception of 'Risk Management'. The item's objectives are reasonably well defined but the title is misleading, as the objectives (correctly) cover both risk and opportunity, not just risk (as the title currently suggests).

UNEP FI's recommendation:

- Adjust the title of the section covering paragraphs 25- 26: 'Risk Management' should be renamed 'Sustainability Management' or 'Management of Sustainability Risks & Opportunities'.
- Relatedly, adjust paragraph 11 part (c):

  c) sustainability risk and opportunity management—the processes the entity used to identify, assess and manage sustainability-related risks and opportunities; and

*(b) Are the **disclosure requirements** for governance, strategy, risk management and metrics and targets **appropriate to their stated disclosure objective**? Why or why not*

The disclosure requirements for 'Strategy', 'Risk Management' and 'Metrics and Targets' are not entirely appropriate:

- **Strategy:** firstly, the content on Sustainability related risks and opportunities (Paragraphs 18-20) are not appropriately placed as part of strategy; they require their own specific space on the same level as the current four items (Governance, Strategy, Risk Management, Metrics and Targets). Contrary to the situation with the climate-related disclosures, the topics to be addressed are not known in advance, thus making it necessary for clarity to users of information what these topics are. They should therefore not be 'hidden' under strategy. Relatedly, the guidance on identification of sustainability-related disclosures and on materiality should be included in this same proposed section (instead of being likewise 'hidden' under 'fair presentation'). Also, the requirement on business model effects lacks guidance; this should be expanded on as with the other 'Strategy' requirements, given the centrality to enterprise value. Finally, the drivers of sustainability-related risks and opportunities (dependencies, impacts and relationships) are inadequately defined and the section needs more balance between managing risk and leveraging opportunities.
- **Risk Management**: the title of this is misleading, as its content (correctly) covers both risk and opportunity, not just risk (as the title currently suggests). The content on opportunity needs further emphasis and development as this has strong implications for enterprise value. Reference to trends forward-looking scenarios is also needed to appropriately understand possible effects on enterprise value.
- **Metrics and Targets**: this section currently refers exclusively to metrics; it could helpfully also refer to indicators, in particular to accommodate situations where qualitative rather than quantitative information will be necessary to disclose on a company's measures to

manage sustainability issues. It is also important that self-defined indicators and metrics be positioned as a needs-basis-only approach so as to favour comparability between company disclosures. Finally, a disclosure requirement is needed concerning baseline data and the external validation thereof.

<u>UNEP FI's recommendation:</u>

The table below illustrates the structural change that might be made based on the comments above. Specific comments and propositions are provided thereafter, section by section.

CURRENT	RECOMMENDED:
Governance **Strategy** • Sustainability-related risks and opportunities • Strategy & decision-making • Financial position, financial performance and cashflow • Resilience **Risk Management** **Metrics & Targets**	**Sustainability topics** • Sustainability-related risks and opportunities **Governance** **Strategy** • Strategy & decision-making • Financial position, financial performance and cashflow • Resilience **Management of Sustainability related risks and opportunities** **Metrics & Targets**

STRATEGY (paragraphs 14-24)

Sustainability-related risks and opportunities (paragraphs 14-20)

The description of the drivers of sustainability-related risks and opportunities (dependencies, impacts and relationships) under paragraph 17 are incomplete and unclear and as such not fit for purpose for preparers of disclosure. In particular, the limitation of the definition to dependencies and impacts on resources is insufficient to capture the breadth of dependencies and impacts that might affect enterprise values. Also, the concept of 'relationships' complicates rather than clarifies or adds to the description of drivers of sustainability-related risks and opportunities.

<u>Illustration:</u>

17-An entity's sustainability-related risks and opportunities arise from its dependencies and its impacts on the natural environment, the societies and the economies it is embedded in. ~~resources and its impacts on resources, and from the relationships it maintains that may be positively or negatively affected by those impacts and dependencies.~~ When an entity's business model depends, for example, on a natural resource—like water—it is likely to be affected by changes in the quality, availability and pricing of that resource. When an entity's activities result in adverse, eternal impacts—on, for example, local communities—it could be subjected to stricter government regulation and consequences of reputational effects—for example, negative effects on the entity's brand and higher recruitment costs. These considerations apply not only to an entities direct operations, but also to its upstream and or downstream activities. ~~Furthermore,~~ Thus, when an entity's business partners (e.g. suppliers or clients) face significant sustainability-related risks and opportunities, the entity could be exposed to related consequences of its own.

Strategy and decision-making (paragraph 21)

Further guidance is required to illustrate point (a) on response to significant sustainability-related risks and opportunities. Also, point (c) on 'trade-offs' could be incorporated into (a) as dealing with these is a subset of the entity's overall 'response'. This latter point should also be reformulated as a broader point on interconnections and how to manage these; the concept of 'trade-offs' erroneously suggests that positive and negative impacts on the natural environment, society and the economy can be 'netted out'.

Illustration:

21-An entity shall disclose information that enables users of general purpose financial reporting to understand the effects of significant sustainability-related risks and opportunities on its strategy and decision-making. Specifically, an entity shall disclose:
(a) how it is responding to significant sustainability-related risks and opportunities, for example:

- Any activities or products discontinued or in the process of being phased out
- Any activities or products started or in the process of being phased in
- Any activities or products altered or in the process of being altered
- Any policies and management processes introduced or adjusted
- Any new or planned R&D activities
- How interconnections between sustainability-related risks and opportunities were considered by the entity (for example, in a decision on the location of new operations, the interconnection between the environmental impacts of those operations and the potential impacts on communities' health and well-being; or , in addition to the employment opportunities the new operations would create, the potential associated benefits to the local economy).

(b) quantitative and qualitative information about the progress of plans disclosed in prior reporting periods; and
~~(c) what trade-offs between sustainability-related risks and opportunities were considered by the entity (for example, in a decision on the location of new operations, a trade-off between the environmental impacts of those operations and the employment opportunities they would create~~

Financial position, financial performance and cash flows (paragraph 22)

The text needs balancing between managing risk and leveraging opportunities.

Illustration:

22[…]
(b)information about the sustainability-related risks ~~and opportunities~~ identified in paragraph 22(a) for which there is a significant risk that there will be a material adjustment to the carrying amounts of assets and liabilities reported in the financial statements within the next financial year;
c)information about the sustainability-related ~~risks and~~ opportunities identified in paragraph 22(a) for which there is a significant possibility ~~risk~~ that there will be a material adjustment to the carrying amounts of assets and liabilities reported in the financial statements within the next financial year;
(d) how it expects its financial position to change over time, given its strategy to address and leverage significant sustainability-related risks and opportunities, reflecting:

RISK MANAGEMENT (paragraphs 25-26)

The title of this section is misleading, as its content (correctly) covers both risk and opportunity, not just risk (as the title currently suggests). The content on opportunity needs further emphasis and development as this has strong implications for enterprise value.

Identification, assessment and monitoring of sustainability are related but distinct processes by the 'soft norms' on the market and should consistently be positioned as such in the Standard. More specific requirements and guidance are need as regards the identification of significant sustainability risks and opportunities

Reference to trends and forward-looking scenarios is also needed to appropriately understand possible effects on enterprise value.

Illustration:

~~Risk management~~ Management of Sustainability Risks & Opportunities

25-The objective of sustainability-related financial disclosures on sustainability risk and opportunity management is to enable users of general purpose financial reporting to understand the process, or processes, by which sustainability-related risks and

opportunities are identified, assessed and managed. These disclosures shall enable users to assess whether those processes are integrated into the entity's overall ~~risk~~ management processes and to evaluate the entity's overall sustainability-related risk and opportunity profile and ~~risk~~ associated sustainability management processes.

26-To achieve this objective, an entity shall disclose:
(a) the process, or processes, it uses to identify sustainability-related:
(i) risks; and
(ii) opportunities;
(see paragraphs 50-55 on Identification and 56-62 on Materiality for further guidance)
(b) the process, or processes, it uses to identify sustainability-related risks for risk management purposes, including when applicable:
(i) how it assesses the likelihood and effects associated with such risks (such as the qualitative factors, quantitative thresholds, trends and forward-looking scenarios and other criteria used);
[...]
(c) the process, or processes, it uses to ~~identify,~~ assess and prioritise sustainability-related opportunities;

METRICS AND TARGETS (paras 27-35)

The section currently refers exclusively to metrics; it could helpfully also refer to indicators, in particular to accommodate situations where qualitative rather than quantitative information will be necessary to disclose on a company's measures to manage sustainability issues. It is also important that self-defined indicators and metrics be positioned as a needs-basis-only approach so as to favour comparability between company disclosures. Finally, a disclosure requirement is needed concerning baseline data and the external validation thereof.

Illustration:

Indicators, Metrics and Targets

27-The objective of sustainability-related financial disclosures on indicators, metrics and targets is to enable users of general purpose financial reporting to understand how an entity measures, monitors and manages its significant sustainability-related risks and opportunities. These disclosures shall enable users to understand how the entity assesses its performance, including progress towards the targets it has set.
28- Indicators and metrics shall include those defined in any other applicable IFRS Sustainability Disclosure Standard, metrics identified from the other sources identified in paragraph 54 and, if and where necessary due to gaps in these sources, indicators and metrics developed by an entity itself.
[…]
31-When an indicator or metric has been developed by an entity, it shall disclose:
(a) how the indicator or metric is defined, including whether it is an absolute measure or expressed in relation to another indicator or metric (such as revenue or floor space) and any sources that have been used to construct the metric;
(b) whether measurement of the metric is validated by an external body and, if so, which body; and
(c) explanations of the methods used to calculate the targets and the inputs to the calculation, including the significant assumptions made and the limitations of those methods.
32-An entity shall disclose the targets it has set to assess progress towards achieving its strategic goals, specifying:
(a) the indicators and/or metric used;
(b) the baseline situation and/or values at the time of formulation of the target and this has been validated by an external body (and, if so, which body); and
(b) the period over which the target applies;
(c) the base period from which progress is measured; and
(d) any milestones or interim targets.

Question 7-Fair presentation (paragraphs 45-55)

(b) Do you agree with the sources of guidance to identify sustainability-related risks and opportunities and related disclosures? If not, what sources should the entity be required to consider and why? Please explain how any alternative sources are consistent with the proposed objective of disclosing sustainability-related financial information in the Exposure Draft.

The proposed sources of guidance to identify sustainability-related risks and opportunities and related disclosures, which focus almost exclusively on ISSB materials, are currently insufficient to meet with the proposed objective of disclosing sustainability-related financial information in the Exposure Draft. The reference to other standard-setting bodies is a good start but focuses too narrowly on 'the most recent pronouncements' and their qualification ('whose requirements are designed to meet the needs of users of general purpose financial reporting') is ambiguous. Most importantly, the identification of sustainability-related risks and opportunities in a way that is fit for purpose to assess effects on enterprise value is a process in and of itself and hence goes beyond the consultation of pre-established lists of sustainability topics per sector – most notably so for entities involved in multiple sectors and activities, either directly or through their upstream and downstream activities.

UNEP FI's recommendation:

- Consider referencing additional norms and resources that producers could refer to for identification purposes, such as the ENCORE[1] mappings of nature-related impacts and dependencies, the OECD Guidelines for Multinational Enterprises[2], the UN Guiding Principles on Business and Human Rights[3], the UNEP Sector/Impact mappings[4] and related identification tools[5], among others. Alternatively, consider referencing the web-based resources of the Impact Management Platform[6], which gathers and categorises such resources.
- Include more specific requirements and guidance on the identification of significant sustainability-related risks and opportunities.

Illustration:

51-To identify sustainability-related risks and opportunities about which information could reasonably be expected to influence decisions that the users of general purpose financial reporting make on the basis of that information, an entity shall refer to IFRS Sustainability Disclosure Standards, including identified *disclosure topics*. In addition to IFRS Sustainability Disclosure Standards, an entity shall consider:
(a) the disclosure topics in the industry-based SASB Standards;
(b) the ISSB's non-mandatory guidance (such as the CDSB Framework application guidance for water- and biodiversity-related disclosures);
(c) the ~~most recent~~ pronouncements of other relevant ~~standard-setting~~ bodies, namely international organizations issuing global standards, goals and data on sustainability-related issues (see annex).
~~whose requirements are designed to meet the needs of users of general purpose financial reporting; and~~
(d) the sustainability-related risks and opportunities identified by entities that operate in the same industries or geographies.

[1] https://encore.naturalcapital.finance/en
[2] http://mneguidelines.oecd.org/guidelines/
[3] https://www.ohchr.org/sites/default/files/documents/publications/guidingprinciplesbusinesshr_en.pdf
[4] https://www.unepfi.org/positive-impact/impact-mappings/
[5] https://www.unepfi.org/positive-impact/unep-fi-impact-analysis-tools/
[6] https://impactmanagementplatform.org/

[new paragraph]-To identify sustainability-related risks and opportunities about which information could reasonably be expected to influence decisions that the users of general purpose financial reporting make on the basis of that information, an entity shall also undertake an impact and dependencies analysis of their business, involving:

(a) A review of their business activities and value chain, identifying both the sector/s and the specific location/s of these activities and the value chain. To this end Standard Industrial Classification System (SICS) should be used, at the most granular level possible.

(b) A review of associated impacts and dependencies, and how these relate to sustainability needs and priorities in the corresponding locations,, based on global frameworks and national regulations and priorities and ideally considering both current and trending needs and involving scenario analysis

(c) A prioritization process to determine sustainability-related topics that qualify as being significant, considering:
   i. Likelihood and salience of impacts and dependencies, which denote an activity or sector as 'key'
   ii. Proportion of business activities associated the identified impacts and dependencies
   iii. Level of need and priority in the relevant locations of the entity
   iv. Opportunities to leverage interconnections between sustainability related topics for better risk management and/or business development

Question 8-Materiality (paragraphs 56-62)

(a) Is the definition and application of materiality clear in the context of sustainability-related financial information? Why or why not?

(b) Do you consider that the proposed definition and application of materiality will capture the breadth of sustainability-related risks and opportunities relevant to the enterprise value of a specific entity, including over time? Why or why not?

(c)Is the Exposure Draft and related Illustrative Guidance useful for identifying material sustainability-related financial information? Why or why not? If not, what additional guidance is needed and why?

While the definition of materiality is clear, its application in the context of sustainability-related financial information lacks clarity due to its reliance on the vague concept of judgement. As a result, there is a significant risk that the proposed definition and application of materiality not capture the breadth of sustainability-related risks and opportunities relevant to the enterprise value of a specific entity. By the same token the content of the Exposure Draft is currently insufficient for identifying material sustainability-related financial information.

UNEP FI's recommendation:

Adjust paragraphs 57-61 for further clarity, including a cross-reference to the preceding section on the identification of sustainability-related topics (where additional clarifications and requirements have also been proposed in the form of a new paragraph).

Illustration

57-Material sustainability-related financial information provides insights into factors that could reasonably be expected to influence primary users' assessments of an entity's enterprise value. The information relates to its dependencies and impacts on the natural environment, the societies and the economies it is embedded in. ~~activities, interactions and relationships and to the use of resources~~ along the entity's value chain if it could influence the assessment primary users make of its enterprise value. It can include information about sustainability-related risks and opportunities with low-probability and high-impact outcomes.
[…]
59- An entity shall apply judgement to identify material sustainability-related financial information, following the process (including prioritization criteria) described in paragraph xxx. Materiality judgements shall be reassessed at each reporting date to take account of changed circumstances and assumptions.
60 -An entity need not provide a specific disclosure that would otherwise be required by an IFRS Sustainability Disclosure Standard if the information resulting from that disclosure is not material, based on .the identification process (including prioritization

criteria) described in paragraph xxx. This is the case even if the IFRS Sustainability Disclosure Standard contains a list of specific requirements or describes them as minimum requirements.
61- An entity shall also consider whether to disclose additional information when, based on the outcomes of the identification process (including prioritization criteria) described in paragraph xxx, compliance with the specific requirements in an IFRS Sustainability Disclosure Standard is insufficient to enable users of general purpose financial reporting to assess the effect on enterprise value of the sustainability-related risks and opportunities to which the entity is exposed.

Question 16 -Cost, benefits and likely effects

a) Do you have any comments on the likely benefits of implementing the proposals and the likely costs of implementing them that the ISSB should consider in analysing the likely effects of these proposals?

The benefits of implementing the proposals are contingent on the scope of the definition of 'enterprise value' adopted (see response to consultation question number one). A broader definition of enterprise value and what affects it will multiply the benefits to users and providers of information alike, thus also making the likely costs of implementing the Standard seem more like an investment.

Question 17—Other comments
Do you have any other comments on the proposals set out in the Exposure Draft?

The GRED is long and complex in the way it has been constructed; a simpler and clearer construction of the standard will facilitate and hence reduce the cost of implementation – especially in jurisdictions with less resources and capacity. Useability of the Standard can be enhanced by streamlining its contents; providing illustrations and templates would also be helpful.