WORLD FEDERATION OF EXCHANGES

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# Response: IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information Exposure Draft and IFRS S2 Climate-related Disclosures Exposure Draft

28 July 2022

## Background

The World Federation of Exchanges (WFE) is the global trade association for regulated exchanges and clearing houses. We represent the operators of over 250 market infrastructures, spread across the Asia-Pacific region (37%), EMEA (43%) and the Americas (20%), with everything from local entities in emerging markets to international groups based in major financial centres. In total, member exchanges trade around $100 trillion a year and are home to some 60,000 companies, with an aggregate market capitalisation of around $120 trillion. The 50 distinct central counterparty (CCP) clearing services (both vertically integrated and stand-alone) collectively ensure that traders put up $1 trillion of resources to back their risk positions.

With extensive experience of developing and enforcing high standards of conduct, WFE members support an orderly, secure, fair and transparent environment for all sorts of investors and companies wishing to invest, raise capital and manage financial risk.

Founded in 1961, the WFE seeks outcomes that maximise financial stability, consumer confidence and economic growth. We also engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play an internationally integrated financial system.

If you have any further questions, or wish to follow-up on our contribution, the WFE remains at your disposal. Please contact:

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# WFE Response to consultations on IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information Exposure Draft and IFRS S2 Climate-related Disclosures Exposure Draft

29 July 2022

## General Comments

Exchanges sit at the interchange between issuers and investors and are crucial players for the operation of standards in a 'live' and constantly evolving environment. The WFE has been a long-standing advocate for harmonisation of sustainability-related reporting requirements, as a means of encouraging consistency and comparability amongst the disclosures provided by listed issuers. The WFE welcomed the establishment of the International Sustainability Standards Board (ISSB) and its objective to provide a comprehensive global baseline for sustainability-related disclosure requirements.

We further support its decision to focus initially on information that is relevant to investors, through an enterprise value lens[1].

Additionally, while it may arguably be helpful to both users and preparers of accounts if the ISSB standards were recognised globally as the reference standards for reporting financially-material sustainability information, local jurisdictions do and are likely to continue to vary in their approach to disclosures, leading to a significant risk of fragmentation.

To this end, it would be helpful to clarify and emphasise further that the core ISSB sustainability standards may support jurisdictional standards (building block approach[2]). For example, the European Union is developing standards that reflect the views of a broader range of stakeholders, and we understand that the building block approach accommodates those jurisdictions that want to go beyond the global baseline.

We note that this 'divergence' should be accommodated as long as the additional information does not conflict with or obscure the information required by the ISSB standards. In addition, coherence between regional and ISSB standards is necessary to reduce the burden of compliance on issuers as many of the largest issuers are global groups containing individual companies that will likely fall under the disclosure requirements of a jurisdiction

[1] With a view to refining this approach to focus on broader stakeholder considerations. We note that, where bond issuance is concerned, it may be appropriate to focus on factors that are directly relevant to the ability to service debt, rather than total enterprise value.

[2] IOSCO envisages that the ISSB's future standards, sitting alongside financial reporting standards and with a focus on enterprise value creation, would form the first block, providing the global baseline. This would be complemented by other 'blocks' (applicable standards), which may be jurisdiction-specific and may focus on wider sustainability impacts or other disclosures that extend beyond the ISSB's enterprise value creation orientation, but could be based on consistent and comparable metrics and methodologies.

following regional standards. Furthermore, it is worth pursuing a formally recognised equivalence framework between ISSB and regional standards to the extent that regional and ISSB standards are sufficiently aligned. This would facilitate cross-border transparency and a common baseline of standards that would better serve issuers and investors.

We welcome the ISSB's attempts to deal with the 'alphabet soup' of sustainability reporting and are pleased to see the Exposure Drafts building upon the Taskforce for Climate-related Financial Disclosures (TCFD) recommendations, as well as incorporating the Sustainability Accounting Standards Board (SASB) requirements. We also welcome the recent collaboration between the Global Reporting Initiative (GRI) and the ISSB to ensure close alignment between these standards through enhanced dialogue. We hope to see further alignment between the ISSB and the Taskforce for Nature-related Financial Disclosures (TNFD).

The WFE's own members, as noted in WFE's Annual Sustainability Survey, recognise that the SASB industry-based approach and specific metrics have helped to provide investors with greater clarity of financially material risks and opportunities that are specific to an issuer's business model and associated activities.

Once again, we reiterate that the ISSB standards should be interoperable with any additional national-level standards, including those in developing markets in order to reduce the reporting requirements and potential burden upon issuers and to provide more convergent disclosures for investors.

On another level, the ISSB should consider developing further implementation guidance to support implementation and to promote consistency of preparer's disclosures in targeted areas. Some issuers would benefit from further information about how to quantify the impact of climate-related risks and opportunities on their financial positions and financial performance.  Additionally, some issuers would also benefit from further guidance related to scenario analysis and trajectories over multiple time horizons.

We encourage the ISSB to consider allowing more flexibility for disclosure requirements that may be challenging due to data unavailability (e.g., Scope 3) or lack of standardisation (e.g., scenario analysis). This would allow preparers to scale up in depth and breadth of disclosures over reporting cycles.

## Specific Comments

We have the following comments to make relating to the 'General Requirements' Exposure Draft and the 'Climate' Exposure Draft:

**The 'General Requirements' Draft**

**Q4a on governance, strategy, risk management and metrics:** *Are the disclosure objectives for governance, strategy, risk management and metrics and targets clear and appropriately defined?*

We fully support the proposed alignment with the TCFD. These recommendations have been widely adopted across our membership and affiliates and provide a coherent approach to disclosing sustainability-related financial information. In WFE's recent annual Sustainability Survey, 97% of the participating exchanges indicated that they had already adopted or planned to adopt the TCFD recommendations.

Additionally, we recommend that an entity should describe sustainability-related risks and opportunities in the context of the entity's overall organisational strategy including a clear trajectory for how the entity will achieve its future plans.

**Q5a on reporting entity:** *Do you agree that the sustainability-related financial information should be required to be provided for the same reporting entity as the related financial statements? If not, why?*

Yes, we agree, however, we would like to emphasise the concepts of proportionality and materiality when providing sustainability-related information on subsidiaries and value chains.

**Q6b on connected information:** *Do you agree with the proposed requirements to identify and explain the connections between sustainability-related risks and opportunities and information in general purpose financial reporting, including the financial statements? Why or why not? If not, what do you propose and why?*

We are generally supportive of the proposals being based on GAAP and IFRS Accounting Standards. This ensures familiarity for entities preparing general purpose financial statements—particularly those preparing IFRS Accounting Standards. This will help with consistency and connectivity in financial reporting. We are pleased to see that the IFRS Foundation has provided examples of how some sustainability-related risks and opportunities are related. This is important because users of reports need to be able to get a sense of the underlying narrative and the relationship between different types of information and how this might impact financial performance over the short- and long-term. Importantly, the implications of these risks (both actual and potential) should also be explained in order to provide investors with the most up-to-date understanding of the financial position of the organisation.
It is also important to ensure that these disclosures do not conflict with local or regional regulations.

**Q7b on fair presentation:** *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 Exposure Draft notes that fair presentation is achieved when applying IFRS sustainability-related disclosure standards, with additional disclosure when necessary. We welcome the consolidation of the existing standard setters, including the CDSB and the Value Reporting Foundation, especially if this signals an opportunity for existing guidance and material to be further utilised within the ISSB framework.

In order to identify sustainability-related risk and opportunities, we welcome that the Exposure Draft directs preparers to refer to: (i) disclosure topics in the industry-based SASB standards; (ii) the ISSB's non-mandatory guidance (including from the CDSB on social issues as well as biodiversity) and (iii) other standard setting bodies whose requirements are designed to meet the needs of users of general purpose financial reporting. These sources of guidance cover the breadth of sustainability-related issues and encouraging preparers to use them will aid with consistency and comparability in disclosure. We further note that our previous concerns related to providing examples of such reporting have been addressed through illustrative guidance within the draft. However, some of our members continue to tell us that they would benefit from further targeted guidance about how to quantify the impact of climate-related risks and opportunities on their financial positions and financial performance.

Overall, we welcome efforts to include industry-based disclosure requirements (as per SASB requirements). This will provide greater transparency to investors and make it easier for preparers to best select those requirements and metrics that suit their business model and needs and will further help with a materiality assessment. As the IFRS Foundation note, it is likely that the metrics within the industry assessment will be relevant for an entity with such a business model and associated activities.

**Q8 on materiality:** *Is the definition and application of materiality clear in the context of sustainability-related financial information? Why or why not?*

We believe that a clear and consistent definition of materiality will enable companies to report relevant and meaningful information. The Exposure Draft states that sustainability-related information is defined as being material if "omitting, misstating or obscuring that information could reasonably be expected to influence decisions that the primary users of general purpose financial reporting make on the basis of that reporting, which provides information about a specific reporting entity".

Whilst this definition has sought to align with general purpose financial reporting, we would stress that preparation of sustainability-related financial information is different in that financial implications will need to be considered over longer time horizons.

Consideration of environmental and social issues (for example, human rights abuses) will require issuers to understand the financial implications of interactions throughout their value chain. Given definitional uncertainties, longer time horizons, etc, we also recommend that the ISSB support local jurisdictions by encouraging the use of safe harbours in their disclosure frameworks.

The WFE is supportive of the notion of dynamic materiality—that material sustainability-related financial information disclosed by a reporting entity might change from one reporting period to another as circumstances and assumptions change, and as materiality judgements and assessments of enterprise value by users of general purpose financial reporting evolves. In the same way that climate-related issues have been at the forefront of investor interest, we believe that the pandemic has created a momentum behind broader environmental risks such as nature-related risks and opportunities as well as social issues. Dynamic materiality will ensure that these risks can be adequately captured.

**<u>The 'Climate' Draft</u>**

**Q2 and Q3 on governance and climate-risk and opportunity**

The Exposure Draft proposes that corporates would be required to disclose information about how a governance body ensures that it has the appropriate skills and competencies available to "*oversee strategies designed to respond to climate-related risks and opportunities*". This may be challenging for smaller company boards where one individual may have oversight over several areas of strategic importance. In order to prevent 'over boarding' and stretching of existing resources, preparers should be able to explain and justify their approach to investors as part of their corporate reporting.

We note that under the General Requirements Draft, companies will be required to provide information that enables investors to assess the connections between various sustainability-related risks and opportunities—including specific climate-related risks. We agree with the proposed approach of integrating oversight of sustainability-related risks and opportunities, including on governance, rather than providing separate disclosures. This will help to prevent duplication and will promote cross-referencing, comparison, and completeness of information.

We further note that climate-related requirements of the SASB standards form the basis for the Climate Exposure Draft, and we welcome the minor updates to the metrics to improve their international applicability and to add requirements for metrics for industries in the finance sector.

It is right that a company should not have to provide comparative information the first time it applies the standards, and could instead adopt a phased-in approach. Given the complexity of meeting some of these requirements, we believe that such an approach will help the provision of valuable information to investors in a timely manner.

Reporting against the standards will be an iterative and evolutionary process and in order to promote consistency globally, the WFE has also asked the SEC to consider a similar approach for its climate-related disclosure framework. We would like to state that over time, though, the 'delta' will be a key metric and measure of change, both globally and regionally. This applies to climate and also to 'the human component'. A 'delta' metric ensures comparability and convergence.

**Q4a on climate-related risk and opportunity in a company's value chain:** *Do you agree with the proposed disclosure requirements about the effects of significant climate-related risks and opportunities on an entity's business model and value chain? Why or why not?*

We note that the definition of value chain that has been adopted by the Exposure Draft is intentionally broad, and that a specific focus on providing information that is limited to that which enables users of general purpose financial reporting to assess an entity's enterprise value is right. Reporting across the entire value chain could impose excessive costs and burdens on preparers given the complexities in verification of the information as well as the reliance on third-party data. We have heard from our members that this can be very time-consuming.

**Q5 on transition plans and carbon offsets:** *Do you agree with the proposed disclosure requirements for transition plans? Why or why not?*

Our members agree that transition plans demonstrate an entity's progress and intentions towards meeting its net-zero targets and transition towards a low-carbon economy. We note that there are currently a number of industry-led frameworks and guidance in the market[3] that can help with disclosure in this area, but without a consolidated framework, there will be a lack of consistency and comparability for investors.

Consequently, we welcome the UK's Transition Plan Task Force which will require UK financial institutions and listed companies to develop and publish "rigorous and robust transition plans that detail how they adapt and decarbonise as the UK moves towards a net-zero economy by 2050". The UK plans to build upon the latest implementing guidance of the Taskforce on Climate-related Financial Disclosure and we would urge the IFRS Foundation to keep up-to-date with and leverage the developments in this space to promote progress globally.

The TCFD-aligned Climate Scores developments by the Swiss Confederation showcase a similar ambition.

We note that the proposals may require preparers to report on the use of carbon offsets in achieving an entity's emission targets. The exchange community has been at the forefront of innovation when it comes to carbon offsets, and their usage can be particularly important in harder to abate sectors. However, we also note that there are disparate views about the extent to which offsetting can be relied upon to achieve effective carbon reduction over the long-term. We agree that an entity's reliance on carbon offsets - how the offsets it uses are generated, and the credibility and integrity of the scheme from which the offsets are obtained - can carry specific risks which could potentially impact enterprise value. Preparers should therefore be required to disclose on the use of offsets as part of an entity's transition strategy. We are aware, however, that in certain jurisdictions, carbon markets are still at nascent levels of development and preparers may be unable to provide detailed disclosures in this area.

**Q7(c) on Climate Resilience:** *Do you agree with the proposed disclosure about an entity's climate-related scenario analysis? Why or why not?*

We note that paragraph 15(b)(i)(4) of the Exposure Draft requires issuers to state whether they have used a scenario aligned with the latest international agreement on climate change. However, while the IPCC has already published its Sixth Assessment Report, the publicly available scenarios are only updated to the Fifth Assessment Report. It takes time for the market to understand or to become familiar with the latest international agreement for application in their reporting. As there would often be a gap between the latest international agreement and the

[3] Such as the Carbon Disclosure Project Framework, the Science Based Targets initiative, the Climate Action 100+ Benchmark, and ICMA's Climate Transition Working Group.

availability of underlying data, we would urge the IFRS Foundation to make note of this in the final version of the standard.

Lastly, we note that there are clear links between climate and nature-related risks and opportunities that should be further explored, assessed and reported in alignment with the regulatory reporting efforts by EFRAG and the EU Taxonomy (biodiversity assessments) and the establishment of a normative framework under the TNFD.