Insights on ISSB and corporate sustainability reporting

By Teresa Ko

13 January 2023

Freshfields Bruckhaus Deringer

Part 1 – scene setting

Climate change is real

Hong Kong, Nov 2022

Blizzards in US, Dec 2022

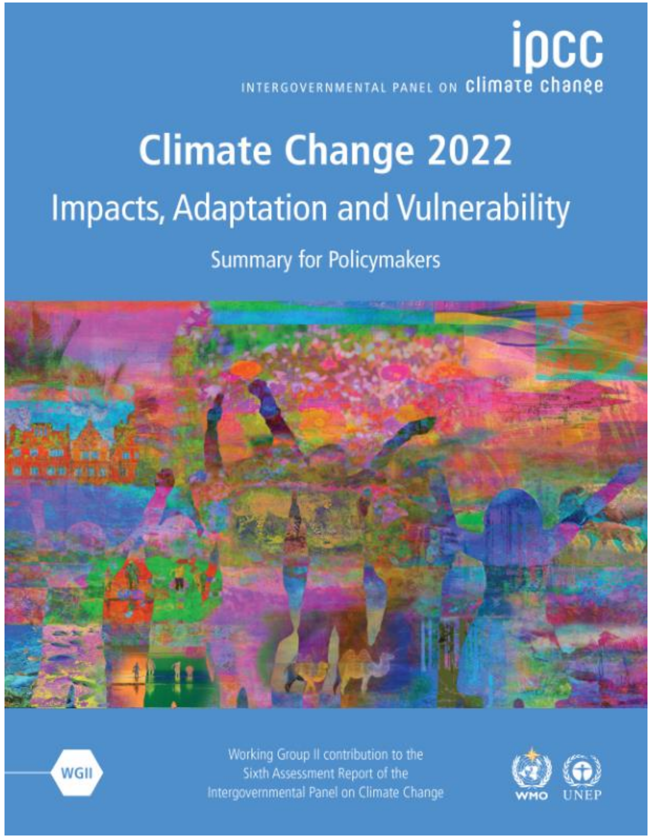
Pakistan, Jul and Aug 2022

Philippines, April 2022

Malaysia, January 2022

South Africa, January 2022

Latest IPCC Report April 2022



“

Unequivocal that human influence has warmed the atmosphere, ocean and land

“

Code red for humanity.

The alarm bells are deafening, and the evidence is irrefutable

“

A litany of broken climate promises. It is a file of shame, cataloguing the empty pledges that put us firmly on track towards an unlivable world.

We are on a fast track to climate disaster

So what does the latest IPCC report say?

Focus on three aspects

- **Use of fossil fuels.** Needs to be abandoned as soon as possible and as a matter of urgency
- **Changes in our diet habits**. Reduce the demand for meat and dairy
- **Greener cities**. Traditional urban organisation must change as soon as possible towards sustainable and more environmentally friendly urban planning

Key findings

- Humans are the main drivers of climate change
- Methane levels at the highest levels in 800,000 years largely caused by agricultural farming, oil and gas operations, and abandoned coal mines
- We are close to reaching irreversible tipping points

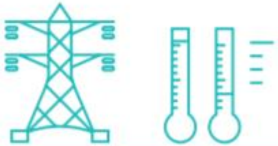
What are Scope 1, 2 and 3 emissions?

Source: HKEX Practical Net-Zero Guide for Business

Scope 1 **Direct emissions or removals from sources**

- Combustion of fuels in stationary sources (e.g. boilers, furnaces, turbines)
- Combustion of fuels in mobile sources (e.g. trucks, cars, ships)
- Physical/ Chemical processing (e.g. cement, aluminium)
- Fugitive emissions (e.g. refrigerants, fire extinguishers)

Scope 2 **Indirect emissions from energy**



- Electricity purchased from power companies
- Heat and/ or cooling purchased

Scope 3 **Indirect emissions from company's upstream/ downstream activities**

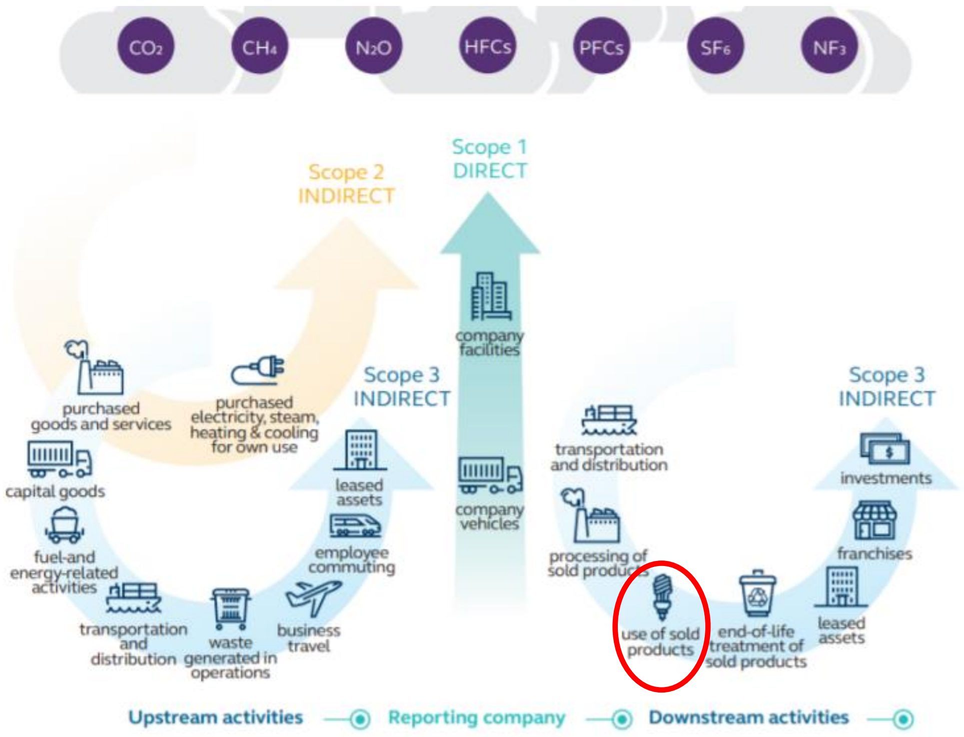
Common sources include:

- Purchased goods and services and capital goods
- Fuel- and energy-related activities (excluded from Scope 1 and 2)
- Upstream/ Downstream transportation/ distribution
- Waste generated in operations
- Business travel

Source: GHG Protocol A Corporate Accounting and Reporting Standard (Revised edition), WBCSD & WRI

Net zero involves eliminating Scope 3 emissions

Source: HKEX Practical Net-Zero Guide for Business



Net-zero and carbon neutrality are different

Source: Dezeen

Net Zero is a target	Carbon Neutrality is a state
No new emissions added to the atmosphere (emissions will continue, but will be balanced by absorbing an equivalent amount from the atmosphere	**no additional carbon dioxide** is added to the atmosphere. This can either involve **eliminating emissions** in the first place, **negating emissions** through offsetting, or a combination of both
Net-zero considers emissions generated by the entire value chain (Scope 3 emissions). **Net Zero must cover Scope 1, 2 & 3 emissions**	Carbon neutrality has a **minimum requirement of covering Scope 1 & 2 emissions** with Scope 3 being encouraged
no internationally recognised standard	defined by the only recognised international standard **PAS 2060 standard**

Countries with net zero targets

More than 130 countries have now set or are considering a target of reducing emissions to net zero by 2050 (United Nations)

Achieved	2030	2035	2040	2045	2050	2060	2070
Bhutan (happiest country in all of Asia)	Uruguay	Finland	Austria Iceland	Germany Sweden	EU USA UK Canada **Hong Kong** Japan France Australia Singapore by or around 2050	China Russia	India

Focus on sustainability is not new

"**Sustainability**" appeared in the Oxford English Dictionary after 1950s

However, the concept has been around for centuries:

- Origin is German – original term was Nachhaltigkeit, meaning "sustained yield."
- First appeared in 1713 (Sylvicultura Oeconomica by Hans Carl von Carlowitz), meaning to **never harvesting more than the forest can regenerate**
- Definition shifted in the 1980s – started to be used in terms of the sustainability of how **humans live on the planet**

A more recent definition of sustainability

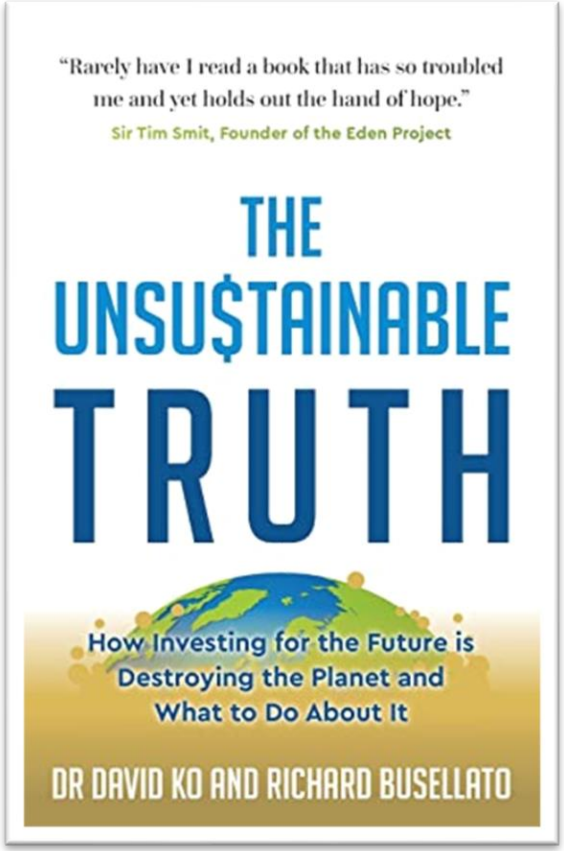
“development that meets the needs of the present without compromising the ability of future generations to meet their own needs”

Bruntland Commission of the United Nations 1987

Evolution of ESG

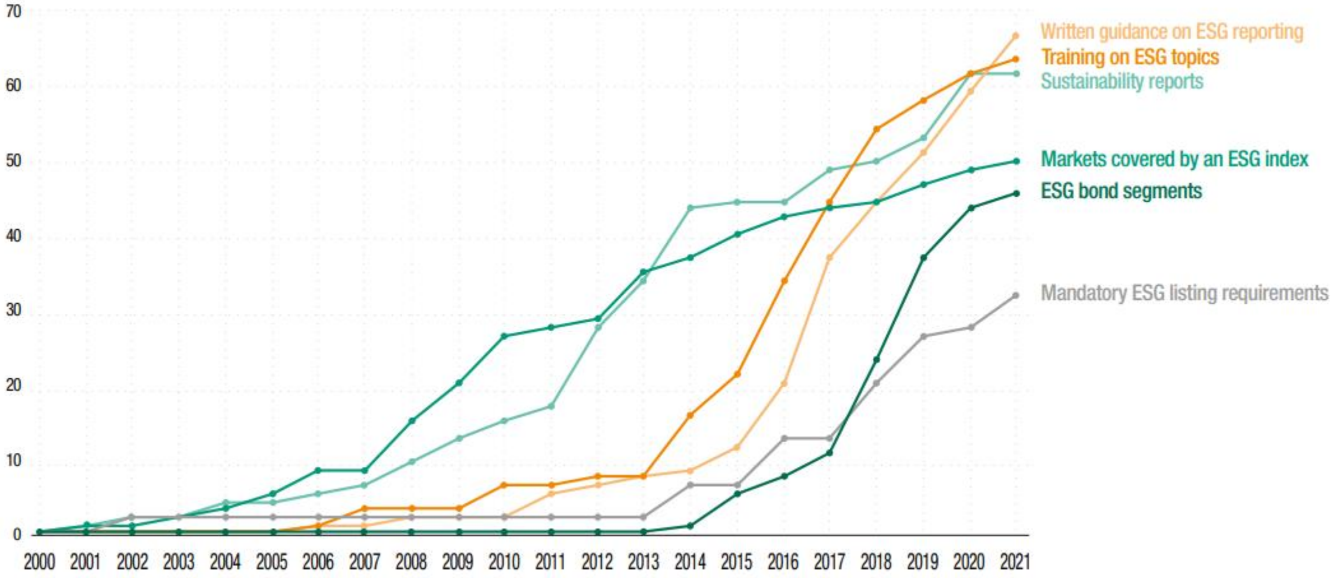
- 1970s – **Milton Friedman** introduced the concept of **shareholder's value** and then shareholder's approach to **CSR** to justify their **pursuit of profit at any cost**
- In 2000s – there was a shift from CSR to ESG –with CSR reports replaced by **more quantifiable and financially-relevant** frameworks of ESG reporting
- ESG was first mentioned in 2004 (18 years ago) in the United Nations Principles for Responsible Investment report titled "**Who Cares Wins – Connecting Financial Markets to a Changing World**"
  - Report argued that embedding ESG factors **into capital markets were relevant business considerations which would lead to more sustainable markets and better outcomes as a whole**
- **Larry Finks' letter to CEOs** in 2018 - "To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society." **debunks the Friedman doctrine** that company's **only duty** is to produce profits for shareholders

Sources: UN Global Compact,
'The Remarkable Rise of ESG' Forbes



"Sustainability is now a major commercial industry"

Global stock exchanges also influence ESG behavior



Source: UNCTAD, SSE database.
Note: ESG = environmental, social and governance.

- Stock exchanges with written guidance on **ESG disclosure for issuers** continues to grow rapidly, from 13 in 2015 to **63 at the end of 2021**
- Stock exchanges covered by **mandatory rules** on ESG disclosure more than **doubled** in the past five years, to 30
- Stock exchanges with **ESG bond segments** continues to grow rapidly, from 5 exchanges in 2015 to at least **44 at the end of 2021**

Source: United Nations Conference on Trade and Development (UNCTAD)'s World Investment Report 2022

Part 2 – the creation of ISSB

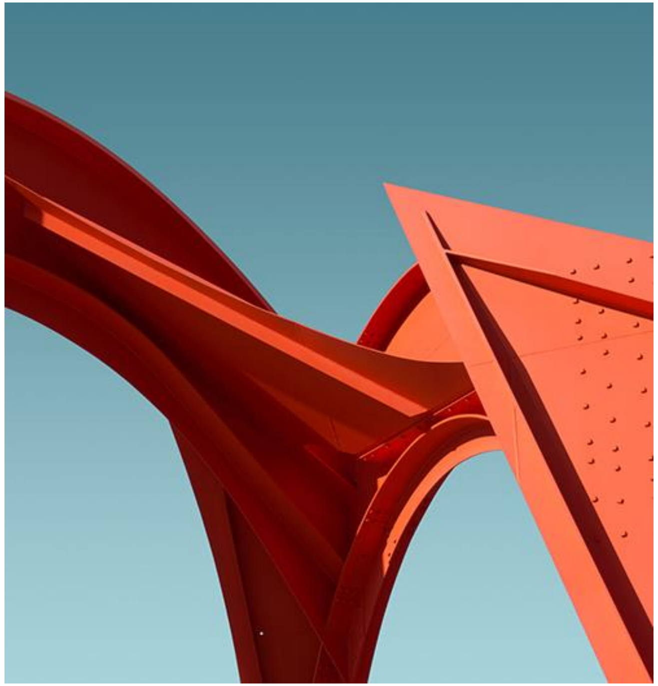
The IFRS Foundation

The IFRS Foundation is not-for-profit, public interest organisation, created 20 years ago.

Its mission is to develop globally accepted reporting standards – which are:

- **High-quality**
- **Understandable**
- **Enforceable**
- **Globally acceptable**

known as IFRS Standards to meet investors and other capital markets participant's needs for transparency, comparability and efficiency, to make economic decisions.



Structure

Public accountability	**IFRS Foundation Monitoring Board**	
Governance, strategy, oversight	**IFRS Foundation Trustees**	
Independent standard-setting	**International Accounting Standards Board (IASB)** **IFRS Interpretations Committee**	**International Sustainability Standards Board (ISSB)**

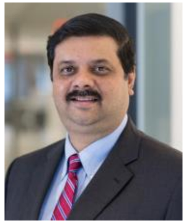
22 trustees of the IFRS Foundation


Erkki Liikanen
Chair


Teresa Ko
Vice-Chair


Larry Leva
Vice-Chair


Dame Colette Bowe
Trustee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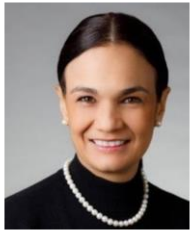
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But sustainability reporting - alphabet soup of more than 600 ESG frameworks and scorecards

Established voluntary international frameworks

Global Reporting Initiative	• Launched in 1997 • Stakeholder-focus • Scope: 33 sustainability externalities
CDP (Carbon Disclosure Project)	• Launched in 2000 • Global scoring system based on annual reporting • Scope: Climate change, water security and deforestation
Climate Disclosure Standards Board	• Launched in 2007 • Focus on ensuring resilient capital markets • Scope: Environment and climate change
SASB	• Launched in 2012 • Investor-focus • Scope: Sustainability issues specific to 77 industries
TCFD	• Launched in 2015 • Investor-focus climate-related risk • thematic areas: governance, strategy, risk management, and metrics and targets
VRF	• Merger between IIRC and SASB in June 2021 • Investor-focus
IIRC	• Launched in 2010 • Focus on organisation's strategy, governance, performance and prospects for creation of value

Attempts to standardise frameworks

Group of 5 climate prototype

Reporting on enterprise value Illustrated with a prototype climate-related financial disclosure standard

- Published in December 2020 by
  - CDP
  - CDSB
  - GRI
  - IIRC
  - SASB
- illustrates how their current frameworks can be used together to provide a running start for development of global standards that enable disclosure of how sustainability matters create or erode enterprise value

WEF IBC 'Stakeholder Capitalism Metrics' White Paper

- White paper - 2020 World Economic Forum
- Backed by big four accountancy firms
- Identifies universal ESG metrics
- 21 core metrics grouped under four pillars of Principles of Governance, Planet, People and Prosperity

Greenwashing is serious and rampant

- The definition of "greenwashing" broadly encompasses companies making ***inflated or misleading environmental claims***
- Banks have been and continue to be criticised of greenwashing for **selectively promoting green initiatives** while omitting information on their **continued financing of companies with substantial greenhouse gas emissions**
- While embracing the long-term climate goal of achieving net zero by 2050 under the 2016 Paris Agreement, banks also **increased their lending and underwriting for projects that produce greenhouse gas emissions**
- According to the Rainforest Action Network, **fossil fuel financing** from the largest banks has reached US$4.6 trillion in the six years since the 2016 Paris Agreement, with US$742 billion in 2021 alone

Why: Strong Demand for the ISSB

Public interest

- The provision of rigorous, reliable and comparable sustainability information enables informed investment and economic decisions.
- This promotes the proper functioning of capital markets, building trust, resilience, efficiency, transparency and accountability.

Sustainability factors are becoming a mainstream part of investment decision-making

- There is a strong desire to address a fragmented landscape of voluntary, sustainability-related standards and requirements that add cost, complexity and risk to both companies and investors.

End the alphabet soup

- There is a strong desire to address a fragmented landscape of voluntary, sustainability-related standards and requirements.
- This is evidenced by the feedback received from multiple consultations with market participants.

International political support

- The ISSB's work is backed by the G7, the G20, IOSCO, the Financial Stability Board, African Finance Ministers and by Finance Ministers and Central Bank Governors from over 40 jurisdictions.

A historic milestone at COP26 on 3 November 2021

1

Formation of the International Sustainability Standards Board (ISSB)

2

Consolidation with Climate Disclosure Standards Board (CDSB) & Value Reporting Foundation (VRF)

3

Publication of climate and general disclosure prototype requirements

ISSB’s objectives

Develop standards for **global baseline of sustainability disclosures**

Meet **information needs of investors**

Enable companies to provide **comprehensive sustainability information** to global capital markets

Facilitate addition of disclosures that are **jurisdiction-specific / aimed at broader stakeholder groups**

A truly global baseline of sustainability disclosures

To deliver the global baseline, the ISSB is focused on:

- 'Truly' **global** by design
- Connected to **financial statements**
- **Consolidation**
- **Thematic** and **industry-based**
- **Building block** approach
- Intersections with **jurisdictional requirements**
- Working with **IOSCO**
- Developed with **assurance** in mind
- Information that is **useful beyond our primary users** in the capital markets
- Compatible with **GRI**

What is the building blocks approach?

Other corporate reporting (multi-stakeholder focus)

GRI

Jurisdictional initiatives

General-purpose financial reporting (investor focused)

Sustainability-related financial disclosures

IFRS Sustainability

Jurisdictional initiatives

Financial statements

IFRS Accounting

Other GAAP

Management Commentary/Integrated Reporting

ISSB members

Emmanuel Faber
Chair

Jingdong Hua
Vice-Chair

Sue Lloyd
Vice-Chair

Richard Barker

Jenny Bofinger-Schuster

Verity Chegar

Jeffrey Hales

Michael Jantzi

Hiroshi Komori

Bing Leng

Ndidi Nnoli-Edozien

Tae-Young Paik

Veronika Pountcheva

Elizabeth Seeger

Current office locations

Frankfurt

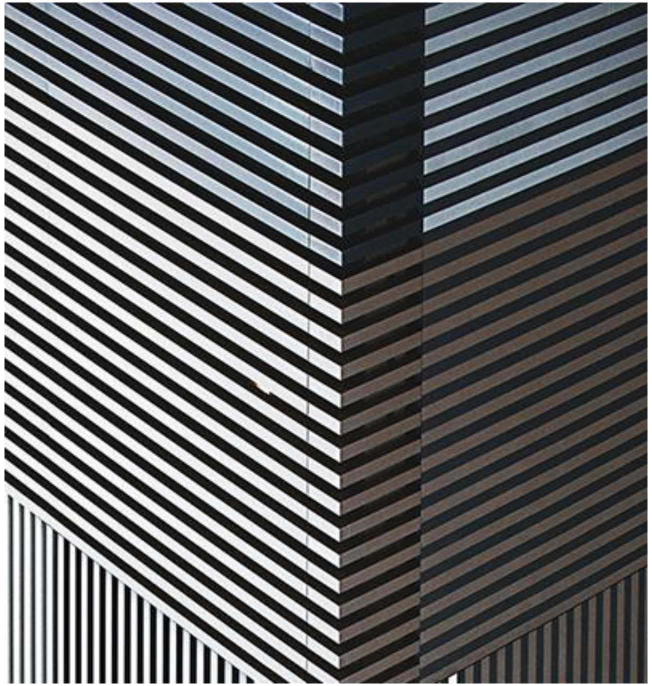
Montreal

London

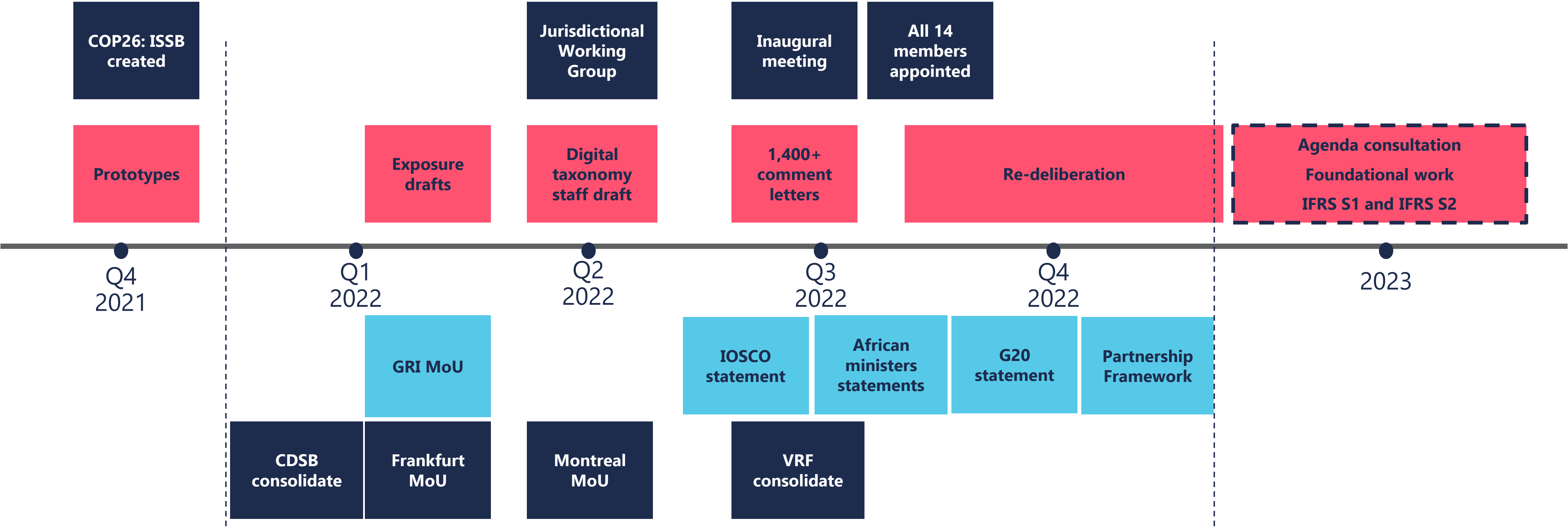
San Francisco

Tokyo

Beijing



ISSB milestones



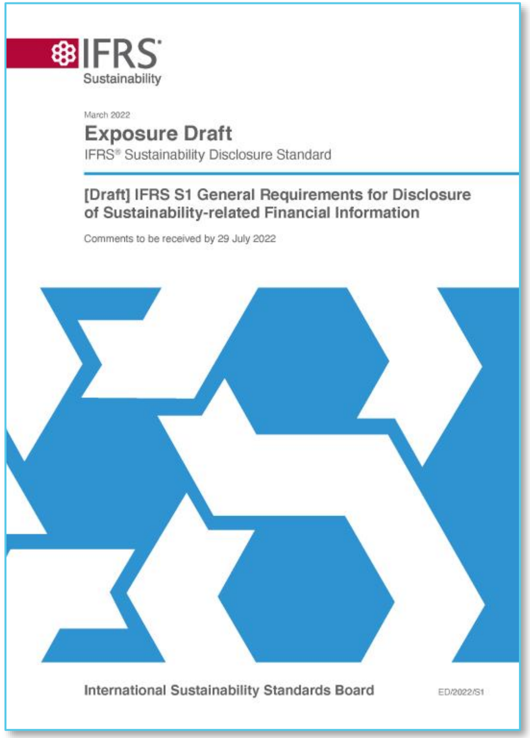
ISSB at COP27: Towards implementation

- Partnership Framework to **support capacity building** and implementation of IFRS Sustainability Disclosure Standards launched
- International **cooperation** with jurisdictions
- CDP to align platform to IFRS S2, **reducing market fragmentation** and supporting the global baseline


Part 3

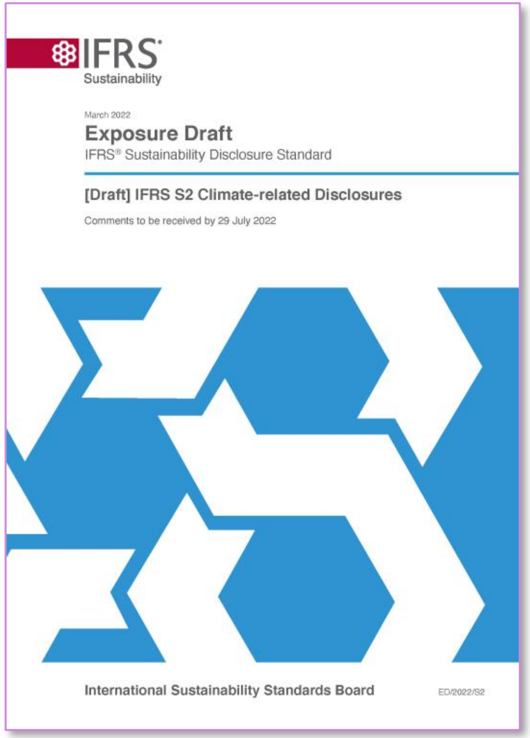
Two proposed IFRS Sustainability Disclosure Standards - published on 31 March 2022

1



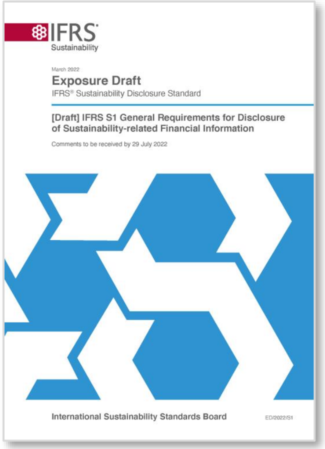
General Requirements Exposure Draft

2



Climate Exposure Draft

Proposed General Requirements Standard: IFRS S1


IFRS
Sustainability
March 2022
Exposure Draft
IFRS® Sustainability Disclosure Standard
[Draft] IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information
Comments to be received by 29 July 2022
International Sustainability Standards Board
ED/2022/S1

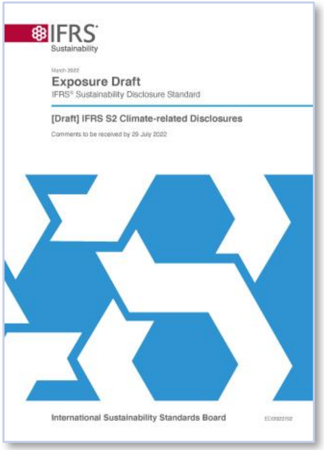
- Sets out disclosure of material information about sustainability-related risks and opportunities
- Sets out general reporting requirements; other IFRS Sustainability Disclosure Standards (eg Climate Standard) set out specific disclosures
- Points to other standards and frameworks in absence of a specific IFRS Standard
- Equivalent to IFRS Accounting Standards IAS 1 and IAS 8

Emphasises need for **consistency and connections** between financial statements and sustainability disclosures

Requires financial statements and sustainability disclosures to be published **at the same time**

Does **not specify a location** for disclosure and **allows additional information** to be provided, to facilitate application in different jurisdictions

Proposed Climate-related Disclosures Standard: IFRS S2


IFRS
Sustainability
Exposure Draft
IFRS® Sustainability Disclosure Standard
[Draft] IFRS S2 Climate-related Disclosures
Comments to be received by 29 July 2022
International Sustainability Standards Board

- Disclosure of material information about climate-related risks and opportunities
- Incorporates TCFD Recommendations
- Includes SASB Standards climate-related industry-based requirements
- Requires disclosure of information about:
  - Physical risks (eg flood risk)
  - Transition risks (eg regulatory change)
  - Climate-related opportunities (eg new technology)

Transition planning
Emissions targets and use of carbon offsets

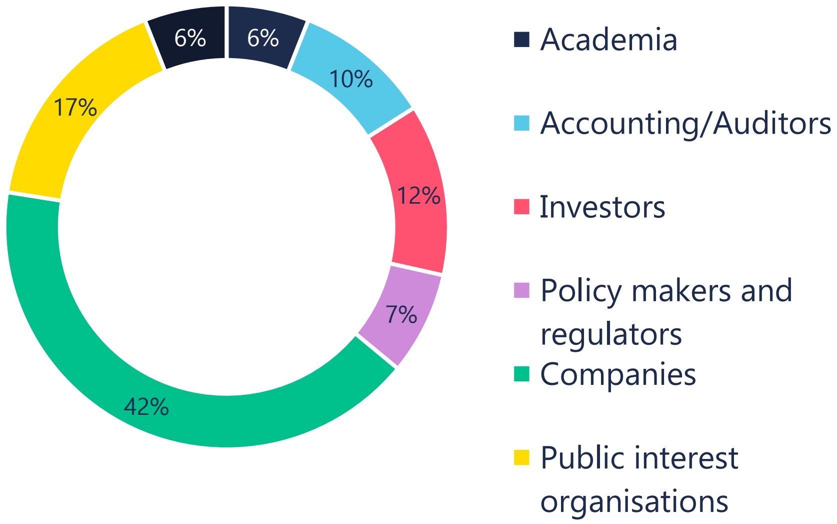
Climate resilience
Resilience of business strategy in multiple scenarios

Scope 1-3 emissions
Requirement to disclose GHG emissions in accordance with th GHG Protocol Corporate Standard

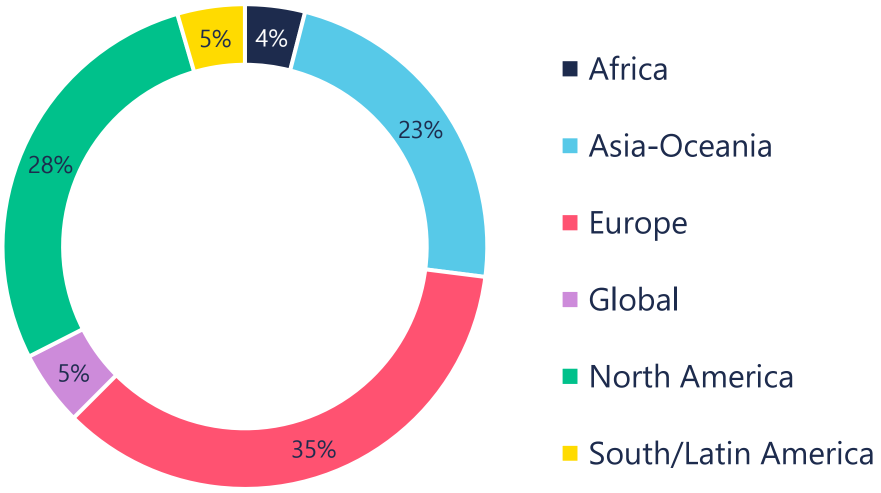
Widespread interest

1,400+ responses to the consultation on Draft Standards

Stakeholder Group



Geographies



High-level messages

Support for **timely publication** and encouragement to continue to move at pace. Support for IFRS S1 as the **overarching standard**, with IFRS S2 well received, especially by **investors**

Need for urgency, citing significant risks that climate change presents to individual companies, as well as to financial stability

Need for **greater support, guidance and examples** to enable effective application

Importance of **interoperability with jurisdictional initiatives** and for **connected standard-setting (IASB** and **ISSB)** to facilitate a package of financial and sustainability-related disclosures that work as a package and can be assurable

Challenges with some specific proposed requirements in IFRS S2, with call for **proportional reporting requirements** for smaller companies and in emerging economies

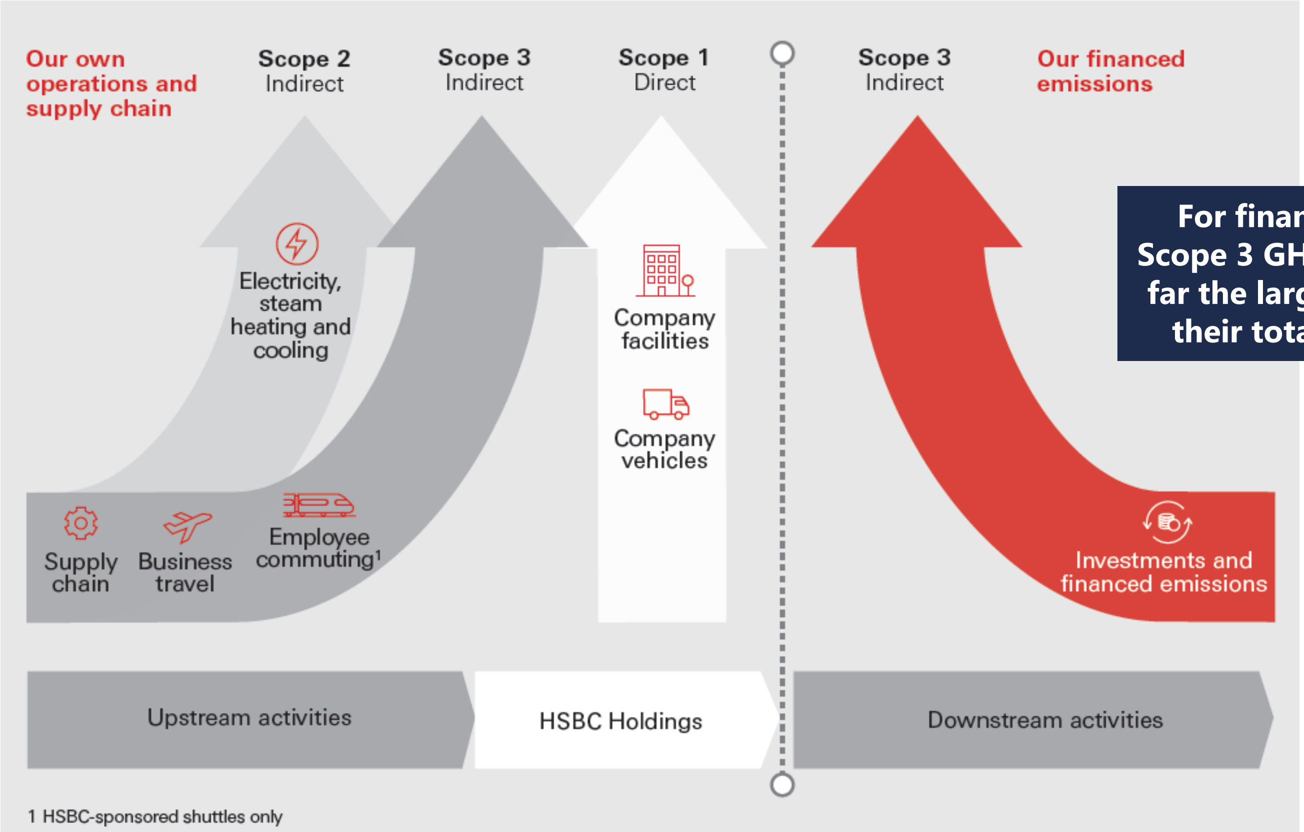
Scope 3 GHG emissions

Investors called for Scope 1, 2 and 3 emissions disclosure to **understand transition risk**

ISSB will help companies **embed and improve their processes for measurement and disclosure** of Scope 3 through:

- **Guidance**: a framework for Scope 3 measurement that requires use of reasonable and supportable information that is available without undue cost or effort and incorporates use of estimation
- **Relief:** temporary exemption for a minimum of one year following the effective date of IFRS S2
- **Relief:** possibility to include information obtained from companies in the value chain with a different reporting cycle

Measuring and managing carbon emissions



For financial institutions, Scope 3 GHG emissions are by far the largest component of their total GHG emissions

Source: HSBC's annual report 2021

Value and sustainability

ISSB describes **sustainability** as

- the ability for a company to sustainably main**tain resources and relationships** and **manage its dependencies and impacts** within its whole business ecosystem over the short, medium and long term
- a condition for a company to **access the resources and relationships needed** (such as financial, human and natural), ensuring their preservation, development and regeneration to achieve its goals

This description

- helps a company explaining **how sustainability-related impacts, risks and opportunities can affect** its performance and prospects
- builds on concepts from **Integrated Reporting Framework**

A company's ability to deliver value for investors is inextricably linked to…

… **Stakeholders** it works with and serves

… **Society** it operates in

… **Natural resources** it draws on

Facilitating interoperability

- **Ongoing dialogue with jurisdictions** working on jurisdiction-specific disclosure requirements
- Many redeliberation decisions – eg enterprise value, Scope 3 – **support interoperability**
- Adopted the **TCFD architecture** to drive interoperability
- Working with European Commission toward a **shared objective** to agree a framework for maximising interoperability

What's next for the ISSB

Complete discussions on consultation feedback around end of 2022

Issue final standards as early as possible in 2023

Work to support **adoption and application**

Consult on proposed **digital taxonomy**

Consult on future priorities, early 2023

ISSB to consult on four projects to further understand standard-setting priorities:

- biodiversity, ecosystems and ecosystem services
- human capital
- human rights
- connectivity in reporting with the IASB

Global Trends

Geopolitical commitment to **decarbonise the global economy**

Investor appetite turning towards **green and sustainable assets**

Increased regulatory and shareholder action against "**greenwashing**"

Macro risks of climate disaster, energy shortages, biodiversity loss, supply-chain issues, social inequity and political uncertainty

What you can do

Stay up to date

Freshfields Sustainability Webpage

- Sustainable business quarterly newsletter
- Webinars
- Thought leadership blogs

Building Experience

- Internships
- Part-time work
- Volunteering and student society involvement

Free ESG online courses

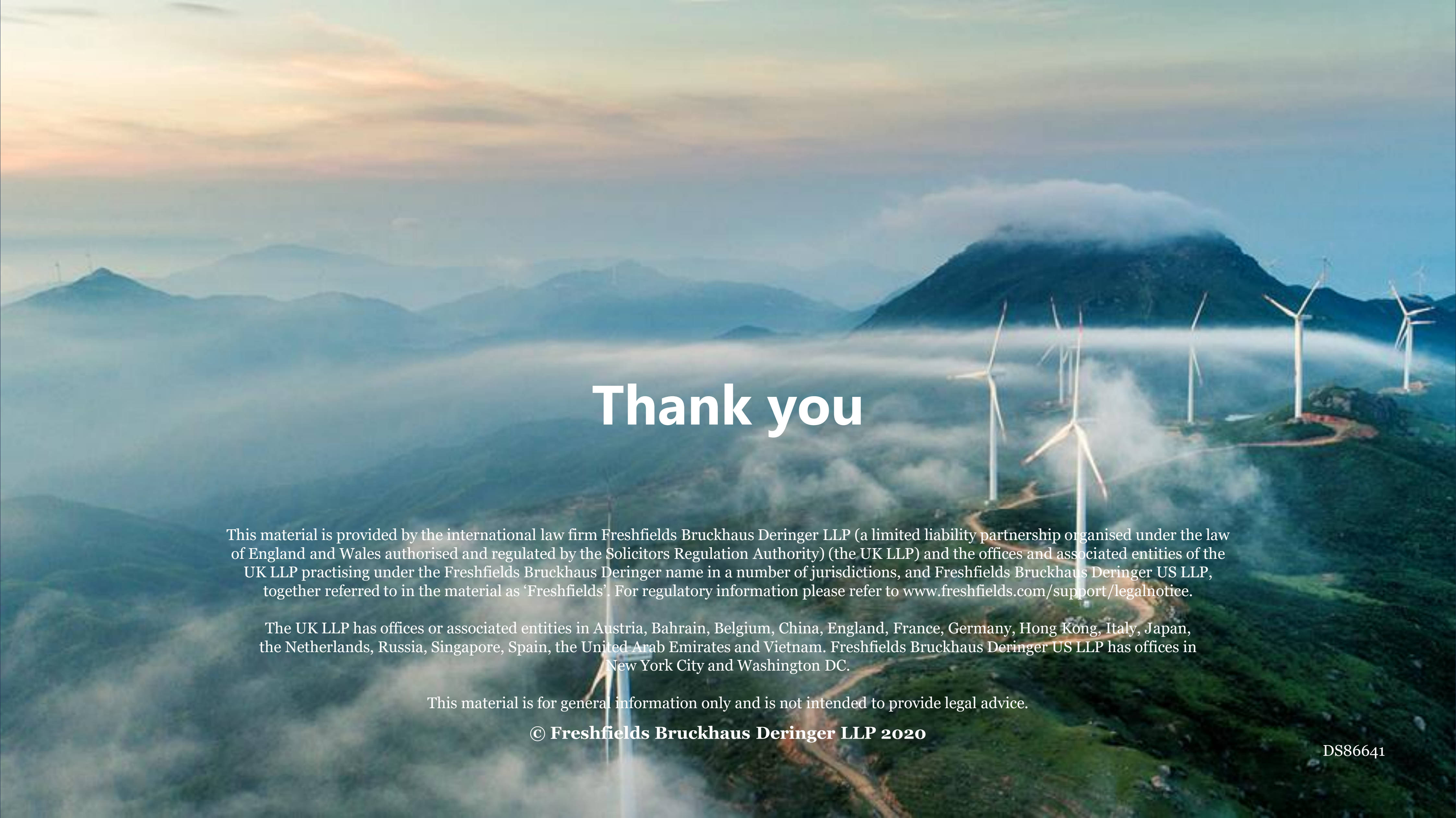
- HKEX's centralised education platform: ESG Academy
- Coursera courses from the University of Pennsylvania
- Universities including: CUHK, INSEAD, Cambridge and Oxford

Things to read

- Larry Fink's 2022 Letter to CEOs: The Power of Capitalism
- Subscribe to FT's Moral Money newsletter
- How to avoid a Climate Disaster by Bill Gates
- Impact: Reshaping Capitalism to Drive Real Change by Sir Ronald Cohen
- Doughnut Economics: Seven Ways to Think Like a 21st Century Economist by Kate Raworth
- The Unsustainable Truth by David Ko and Richard Busellato
- Newsweek Article on "Climate Change Will Bankrupt Us Before It Drowns Us"

Things to listen to

- Freshfields' Sustainability Podcast
- ESG Insider: A podcast from S&P Global



Thank you