CPP Investments

July 29, 2022

International Sustainability Standards Board (ISSB)
Emmanuel Faber, ISSB Chair
Sue Lloyd, ISSB Vice-Chair
Columbus Building, Westferry Circus
Canary Wharf, London E14 4HD
United Kingdom

Dear Chair Faber and Vice-Chair Lloyd,

Thank you for the opportunity to comment on the two proposed IFRS Sustainability Disclosure Standards – IFRS S1, *General Requirements for Disclosure of Sustainability-related Financial Disclosures* and IFRS S2, *Climate-related Disclosures*. CPP Investments welcomes the formation of the ISSB announced in November 2021 and the drive towards the development of standards for a global baseline of sustainability disclosures, and the consistency and comparability of sustainability-related financial information. Our comments build on our responses dated December 2020 and July 2021 addressed to the IFRS Foundation Trustees.

CPP Investments is the professional investment management organization that invests Canada Pension Plan (CPP) funds not currently needed to pay benefits. Our public purpose is to help provide a foundation upon which the CPP's 21 million contributors and beneficiaries can build their financial security in retirement. As of March 31, 2022, the Fund totals C$539.3 billion in net assets. Our investment strategy is designed to fulfill our legislative mandate of maximizing returns without undue risk of loss.

As an investor, we accept the division of authority and responsibilities among the triad of interests that is the core of good corporate governance: shareholders own the company; the board of directors approves strategy, monitors its implementation, and oversees management; and management develops and implements strategy and runs day-to-day operations.

We seek disclosure of sector-based, material sustainability-related information from companies to allow us to better understand, evaluate and assess the potential impact of these issues on a company's performance. We advocate with companies for broad alignment of their sustainability-related reporting, including climate change, with the Sustainability Accounting Standards Board (SASB) Standards and the Task Force on Climate-related Disclosures (TCFD) recommendations.

We believe the proposed disclosures laid out in IFRS S1 and IFRS S2 will support and accelerate the move towards reliable and consistent reporting of material sustainability-related data by companies. We support the IFRS Sustainability Standards being recognized globally as the baseline reference standards for reporting material sustainability-related financial information.

The *General Requirements for Disclosure of Sustainability-related Financial Disclosures Exposure Draft* asks that companies disclose sustainability-related information at the same time as their financial reporting. It also requires companies to explain the connections between the different sets of information, which we welcome. This will help provide investors a complete picture when assessing a company's value. The requirement that a reporting entity disclose material information about all significant sustainability-related risks and opportunities to which it is exposed and to consider SASB Standards for their reporting will provide useful clarity to companies on how to approach sustainability reporting during the transition period while IFRS builds out its Sustainability Standards.

Our comments in this submission are guided by three key observations from our experience working with our investment partners and the companies in which we invest to create sustainable value over the long term: (i) independent governance and the provision of oversight and counsel to the executive on the identification and management of material sustainability-related factors is a critical determinant of success; (ii) the most material sustainability-related factors are a by-product of the industry in which the company operates; and (iii) sustainability-related factors are engaged with most effectively when boards of directors recognize that anticipating, managing and integrating these factors into strategy will both create value and reduce risk.

These observations highlight the need for reporters to outline the governance framework for ESG oversight, the benefits of sector-based reporting standards and that it is imperative to maintain a focus on the reporting of data that is material to value creation or risk mitigation for the enterprise.

CPP Investments responses to specific questions are outlined below.

<u>IFRS S1, Question 1 – Overall approach</u>

a) Does the Exposure Draft state clearly that an entity would be required to identify and disclose material information about all of the sustainability-related risks and opportunities to which the entity is exposed, even if such risks and opportunities are not addressed by a specific IFRS Sustainability Disclosure Standard? Why or why not? If not, how could such a requirement be made clearer?

It is clear that an entity would be required to identify and disclose material information about all of the significant sustainability-related risks and opportunities to which it is exposed, in the context of information necessary for investors as users of general-purpose financial information to assess enterprise value. This is clearly stated in paragraph 2 of the draft.

The Exposure Draft, however, does not consistently use reference to *significant sustainability-related risks and opportunities*. For example, the wording in paragraph 50 with respect to identification of sustainability-related risks and opportunities does include reference to *significant* sustainability-related risks and opportunities but paragraph 51 does not. In addition, the Exposure Draft does not define *significant* and does not provide guidance or context as to the relationship and or differences between the *significance and materiality* of the sustainability-related risks or opportunities a reporting entity is expected to identify. Greater clarity with respect to the definitions, distinctions and relationship between these two concepts would be beneficial. Alternately, the ISSB may simply wish to delete the concept of *significant* in favour of consolidation around the concept of *material*.

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

CPP Investments agrees that the proposed requirements set out in the Exposure Draft generally meet its proposed objective as stated in paragraph 1 subject to the caveat that the Exposure Draft subjects all sustainability-related disclosures to a materiality threshold as determined by the reporting entity.

While we agree that materiality should drive disclosures about specific risks and opportunities, the TCFD expressly requires that governance and risk management process disclosures should be made in all cases, notwithstanding materiality. Based on our experience of the importance that governance plays in the successful integration of ESG into corporate strategy and risk management, we recommend that the ISSB follow the TCFD's approach with respect to governance and risk management disclosures not being subject to materiality and, in addition, should require disclosures with respect to materiality assessments.

Descriptions as to how a reporting entity approaches its governance and risk management for identifying material sustainability-related risks and opportunities is relevant to investors, including the process a company uses to determine what information and topics are material enough to disclose. This materiality assessment and discussion of the methodology used to perform such an assessment should be a part of the general requirements for sustainability-related disclosure as they are relevant to identification and determination of what other IFRS Sustainability Disclosure Standards may apply and could potentially avoid duplicate disclosures in such other standards.

CPP Investments does not believe that there is a prescriptive, one size fits all approach to the board oversight of sustainability-related risks and opportunities, and individual boards are best positioned to determine how oversight is exercised. As such, disclosure becomes a valuable tool for companies to inform investors as to how directors are discharging this core obligation to the company.

The Exposure Draft expressly does not require disclosures with respect to how a reporting entity applies its materiality assessments to such sources in order to identify the topics against which it should disclose.

Instead, the Exposure Draft incorporates an assumption that by identifying only the categories of industries a reporting entity has determined are applicable, the information a reporting issuer decides to disclose relevant to that industry is de facto what is material. Therefore, the fact of what has been disclosed against is sufficient information for an investor to understand what has been "referred to" or "considered" and determined to be immaterial. Paragraph BC 66 of the Basis for Conclusions on [Draft] IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information states:

By disclosing industry or industries that an entity has identified as being applicable, the Chair and Vice-Chair intended that greater transparency would be provided about the materiality assessments that an entity has made. In particular, it would be apparent if an entity did not disclose a metric that is required to be provided for an entity in that industry, subject only to materiality. *The Exposure Draft does not propose a disclosure about how materiality assessments have been made as there was concern that such disclosures may be boiler plate*. [Emphasis added]

We disagree. If, for example, water withdrawal has been determined as material to the reporter's industry and is included in the SASB standard for the industry, we would expect the issuer to provide an explanation as to why it had concluded it were not material to their business model, in order to provide context to their decision not to measure, manage or report this factor rather than simply omit the data.

The proposed approach requires investors to assume that non-disclosure about a specific set of industry specific sustainability disclosures means the factor they cover is not material. Our experience suggests that failure to report specific metrics more often reflects the board has not considered this factor, rather than having actively evaluated and rejected its materiality, or that the reporter's performance on the metric is weak. We must ensure that poor performance is not conflated with materiality when evaluating a decision not to report what other companies have deemed material to the industry. Shareholders as owners of the company deserve insight into how such determinations of materiality were made and/or how governance oversight was exercised.

Our ability to consider and integrate material sustainability-related factors into our investment analysis relies on ESG information that is consistent, comparable, accurate and, ultimately, useful for making investment decisions. As sustainability-related risks accrue across industries, the benefit of sector-based materiality is key. The sector-specific SASB Standards encourage companies to disclose potentially material industry-specific sustainability-related factors that most directly impact long-term enterprise value. For this reason, we encourage companies to look to the sector-specific SASB Standards when making their materiality assessments for sustainability-related disclosures.

<u>IFRS S1, Question 2 – Objective</u>

(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?

We would recommend that the definition be amended slightly (as set out below) to recognize that governance-related information is important for users of sustainability-related financial information to assess the implications of sustainability-related risks and opportunities on enterprise value.

> **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 **<u>[governance oversight of and]</u>** resources and relationships on which an entity's business model and strategy for sustaining and developing that model depend.

<u>IFRS S1, Question 8 – Materiality</u>

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

The definition of materiality is found in Paragraph 56 and states:

Sustainability-related financial information is 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.

We agree with the investor focus of the definition. We further agree that the reporting entities are the appropriate entities to determine materiality and that it requires judgement specific to the entity [see Paragraphs 58 and 59]. We further agree that reporting entities should not be required to make non-material disclosures [see Paragraph 60].

We do not agree, however, that reporting entities should not be required to disclose their processes and assumptions with respect to how materiality assessments are made and judgement is exercised and how governance oversight of such decisions is addressed by the reporting entity's board. Please see our response to Question 1(a) and (b) above.

As a small point, we recommend that the definition be moved to Appendix A with other definitions to facilitate users finding it easily.

CPP Investments agrees that this definition is clear and generally aligned with Canadian capital markets definitions and also clarifies that materiality is linked to information that could reasonably be expected to influence investor decisions.

IFRS S1, Question 10 – Location of information

(a) Do you agree with the proposals about the location of sustainability-related financial disclosures? Why or why not?

The approach recommended by the IFRS is consistent with other jurisdictions and will support standardization of disclosure and comparability as between companies because investors will not have to search multiple online locations and documents in order to find disclosures related to sustainability-related risks. In addition, by requiring the disclosures to be part of the same package as the general-purpose financial reporting, such disclosures will be subject to the same level of oversight and scrutiny by the board and senior management, enhancing the attention paid by the company to its sustainability-related disclosures and supporting the reliability of what is disclosed.

We further agree that the IFRS should not prescribe a particular location within the package as this is best determined at the jurisdictional level consistent with domestic regulatory practices.

(c) Do you agree with the proposal that information required by IFRS Sustainability Disclosure Standards can be included by cross-reference provided that the information is available to users of general-purpose financial reporting on the same terms and at the same time as the information to which it is cross-referenced? Why or why not?

Our preference is for all sustainability-related information to be disclosed in one place. If cross-referencing is permitted, all cross-referenced disclosures should be subject to the same board and executive oversight requirements as the general-purpose financial reporting.

IFRS S1, Question 13 – Effective date

(a) 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, those using the sustainability-related financial disclosures and others.

We recommend that the ISSB consider a phased or rolling implementation given that it will take some time for reporting entities to become fully compliant with the requirements of the Exposure

Draft. We would recommend that the ISSB consider requiring governance and risk management disclosures to be implemented first, with strategy and metrics and targets to follow. This is how the TCFD framework on which the Exposure Draft is based was intended to be implemented and also is consistent with engaging the board in the foundational work of integrating sustainability-related governance and risk oversight into the governance mechanisms of the reporting entity.

In addition, we would recommend that the ISSB consider proportionality when considering effective dates and potentially provide a longer implementation for smaller and less sophisticated reporting entities. This is similar to approaches being considered in the context of proposed regulatory climate-related disclosure regimes in Canada and the United States. Such entities may not be as far along in considering or disclosing on sustainability topics and have a further learning curve than larger and more sophisticated reporting entities.

IFRS S1, Question 16 – Costs, 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?

With respect to materiality, as owners of the companies we invest in, we appreciate that the monitoring of ESG data comes at a cost, but we also observe that when material ESG opportunities are identified and captured and material ESG risks are identified and mitigated, that the investment in maintaining, managing and reporting this data typically pays for itself. This reality is an important consideration for owners and reporters in defining materiality. Where it is immediately intuitive to a reasonable observer that improving performance on an ESG metric will enhance value or reduce risk, we observe reporters typically derive value from managing it. When required to report on metrics that are not intuitively tied to value creation or preservation, we observe two undesirable outcomes for both the owner and the reporter; namely incurring costs that create no value and perhaps of greater concern, the risk that ESG integration is viewed as a box ticking exercise rather than an integral part of corporate strategy orientated towards value creation. We respectfully request that the ISSB keep this balancing act top of mind when framing materiality for ESG reporting.

IFRS S2, Question 5 – Transition plans and carbon offsets

(a) Do you agree with the proposed disclosure requirements for transition plans?

(b) Are there any additional disclosures related to transition plans that are necessary (or some proposed that are not)? If so, please describe those disclosures and explain why they would (or would not) be necessary.

CPP Investments agrees with the proposed disclosure requirements for climate change-related transition plans in IFRS S2. In addition, we believe that reporting of transition plans can be enhanced through our proposed abatement capacity framework, which would provide investors with consistent, comparable and decision-useful information about issuers' transition plans and the economic feasibility of their net-zero commitments.

In October 2021, CPP Investments published a proposal for market adoption of a reporting standard that would direct issuers to project their capacity to abate greenhouse gas (GHG) emissions. This reporting framework, a Transition Capacity Assessment, would fill critical information gaps for investors and boards, who require concrete disclosure from issuers and their management about a company's ability to abate GHG emissions.

Whether it is the intention of issuers or not, corporate climate change commitments are increasingly being used to assess the long-term viability of the business model. For example, a growing number of issuers (>2,000)[1] have provided long-term forward-looking statements that their operations will be net zero by 2050; and more than 20%[2] of the world's largest companies have net-zero GHG targets. However, the scope of what is included in these targets and statements differs considerably. While initiatives like the Science Based Targets Initiative (SBTi) provide an objective appraisal of whether the plans are sufficiently ambitious and use appropriate levers to decarbonize, the market currently has no convention for issuers to report the economic feasibility of delivering against their commitments. This creates a novel risk for issuers and investors relying upon this forward-looking guidance and presents uncertainty for those regulating the issuers and the markets where they are listed.

By providing standardized disclosure about a company's current and projected ability to abate its GHG emissions, based on current pricing, technology, and regulations, we believe the framework would help investors have a greater degree of confidence in a company's commitment and ability to transition to a low-carbon future. Transparency of the economic feasibility of transition plans allows investors to make better informed capital allocation decisions and thus, protect the interests of their beneficiaries.

The proposal suggests that companies conduct "abatement capacity assessments" and report "projected abatement capacity." The former is the process of allocating current GHG emissions to specific decarbonization drivers, e.g., efficiency, greening of power supplies and deployment of technology economic to abate under current and future carbon price assumptions.

Once 100% of GHG emissions have been attributed, they are translated into a pro forma matrix of "projected abatement capacity." This matrix can provide a clear view of which emissions are economically viable to abate now, which emissions would become economic to abate at higher carbon prices, and lastly those emissions currently uneconomic to abate even at $150/tCO2e. In essence, the framework could provide its users with proven, probable and still to be determined GHG abatement capacity for any issuer, in any sector with operations in any geography.

We recently conducted an abatement capacity assessment with one of our portfolio companies. In less than 2 months, we were able to quantify the projected abatement capacity of the business, providing the board and executive team the insights to develop a robust transition plan, and providing us confidence in the low risk of value impairment for this asset.

CPP Investments encourages the ISSB to consider integrating this framework as supplemental disclosure for issuers making net-zero commitments to provide consumers of these forward-looking statements the ability to assess the feasibility of this guidance.

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[1] Science Based Targets initiative – www.sciencebasedtargets.org link

[2] Taking Stock: A global assessment of net zero targets – ECIU and Oxford Net Zero (University of Oxford) link

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<u>IFRS S2, Question 11: Industry-based requirements</u>

(a) Do agree with the proposed industry-based requirements? Why or why not?

We agree with the industry-based requirements derived from the SASB Standards. We nonetheless believe that the development of a sector-neutral approach for climate change-related disclosures should be a priority for the ISSB. Climate risk is both systemic and pervasive across all industries in the economy; with more countries committing to net zero we anticipate the definition of "going concern" will evolve to reflect that the business is viable in a net zero economy. On this basis, climate change stands out as an ESG factor that can largely be reported via a sector neutral framework. However, we believe this would need to be supplemented with sector-specific data to meet the materiality test; e.g., sources of fugitive methane release would be a material contribution to emissions for some industries, but not meaningful in others, while Scope 1 and Scope 2 emissions would be material for all.

<u>IFRS S2, Question 14: Effective date</u>

(b) 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?

(c) When the ISSB sets the effective date, how long does this need to be after a final Standard is issued?

Please see response to IFRS 1, Question 13 above. In addition, we support the effective date of IFRS S2 being the same as IFRS S1.

Conclusion

We believe standardization of dislosures of sustainability-related financial information to a consistent set of decision-useful information will be in the interest of all parties in the financial system. While voluntary approaches to sustainability reporting have progressed considerably over last two decades, convergence is needed to deliver comprehensive, consistent, comparable and assurable disclosures, but also to dramatically streamline the cost of preparation for issuers.

We believe the creation of the ISSB is a watershed moment that will accelerate the convergence towards globally recognized sustainability-related disclosure standards that are industry-specific and rules-based. This information is critical for investors to determine the effects of sustainability-related matters on companies' enterprise value over the short, medium and long term.

Sincerely,

Richard Manley
Managing Director, Head of Sustainable Investing, CPP Investments