EUROPEAN CENTRAL BANK
EUROSYSTEM

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Dear Mr Faber,

I would like to take the opportunity of the publication of the exposure drafts of the IFRS Sustainability Disclosure Standard to congratulate you on the establishment of the International Sustainability Standards Board (ISSB), your appointment as its Chair and the progress made towards delivering a global baseline of sustainability disclosures.

Addressing climate change and accelerating the transition towards a sustainable economy are urgent global challenges. Consistent and reliable corporate sustainability disclosures – in particular, improved quality and availability of climate related information – are essential to provide investors, policymakers and all relevant stakeholders with the key information to understand and manage the interdependencies between economic activities, our environment and society at large.

The ECB considers that the current state of corporate sustainability disclosure prevents regulators, supervisors, financial stability authorities and central banks from appropriately assessing exposure to sustainability and, notably, the climate-related risks of corporates and – in turn – of credit and financial institutions that make use of corporate disclosures to take financing decisions. Hence the ECB strongly supports the goal of promoting global transparency and enhancing public disclosures of these risks.

The IFRS Sustainability Disclosure Standard could help address these data gaps, supporting collective efforts to mitigate climate change, improving the resilience of the financial sector to climate risks, and ensuring an orderly transition to a climate neutral and sustainable economy. The ECB encourages the ISSB goal to provide an ambitious global baseline standard and welcomes the opportunity to provide its feedback on the exposure drafts, which is formulated in the Annex of this letter.

Yours sincerely,

[signed]

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Annex

1. Global baseline

Given the global nature of climate and sustainability challenges, globally coordinated action is essential. Internationally consistent standards on sustainability disclosure would foster comparable information and provide greater clarity to the financial industry on how to align its reporting internationally, while avoiding unnecessary double reporting. Hence the ECB strongly supports the ISSB's ambition of providing a global baseline standard establishing a harmonized minimum standard common across all jurisdictions. The ISSB's initiative offers a unique window of opportunity for reducing the existing and further fragmentation of sustainability disclosure requirements across the globe, while the baseline approach would avoid constraining the ambition of regional or national approaches, thereby making it possible for jurisdictions to go beyond the baseline to meet their own specific needs and aspirations.

The ECB urges the ISSB and national and regional standard-setters, as well as other bodies behind reporting initiatives, to actively cooperate to minimise divergences. For the ISSB standard to effectively establish itself as a common baseline, it will need to be adopted or closely adhered to in national and regional frameworks. To this end, the ECB urges the ISSB and national and regional standard-setters, as well as other bodies behind reporting initiatives, to actively cooperate with the aim of ironing out differences and reaching baseline standards that are widely implemented globally. Accordingly, the ECB strongly supports the ISSB's establishment of the Sustainability Standards Advisory Forum, which should serve as the main platform for mutual learning and convergence between the ISSB and national and regional authorities. Cooperation between the ISSB and regional/national jurisdictions should be driven by a genuine effort by all parties towards convergence. The ECB encourages jurisdictions to aim for the maximum degree of consistency and, at a minimum, interoperability of national and regional standards and the ISSB global baseline. This will be key to minimising fragmentation of reporting requirements, reducing reporting burdens, and ensuring the availability of consistent sustainability information for users.

The priority should be delivering a strong and reliable standard. While global consistency is of key importance, it is by no means the only goal, nor the primary one, against which the success of the ISSB standard should be assessed. Addressing the current poor quality, quantity and reliability of sustainability information requires, first and foremost, setting a sound and high-quality standard that fully meets the needs of the relevant stakeholders, encompasses all key information and leaves no room for opportunistic or misleading disclosure practices. The ECB's expectation is that the ISSB will deliver a *strong* and *reliable* standard. In this spirit, the goal of achieving a global baseline should not come at the expense of the substantive quality of the standard and downward compromises should be avoided. The ECB therefore calls on the ISSB to aim for an upward convergence process: the global *baseline* should not be a *lowest common denominator* across all jurisdictions, but rather provide a sound basis and an authoritative positive example that will foster improved disclosure practices globally.

2. Climate disclosures

The scale and urgency of the climate challenge requires the global climate baseline to be commensurate with the ambitious action needed by all economic players to meet the climate goals. The ECB is of the view that the ISSB climate standard should make it possible for stakeholders to obtain reliable and comparable climate-related information and thereby contribute to climate action consistent with the Paris Agreement goals. In this respect, the draft climate standard (Exposure Draft IFRS S2) seems, in some instances, to fall short of the level of ambition and reliability that the ECB considers to be necessary. The ECB would like, in particular, to draw attention to the following issues:

- **The disclosure of transition plans should make direct reference to the Paris Agreement goals.** Paragraph 13 of the Exposure Draft IFRS S2 proposes that disclosures encompass how an entity plans to achieve any climate-related targets that it has set for itself, but no reference is provided to anchor such transition plans to the Paris Agreement goals and therefore no direct assessment is possible of whether an entity's transition plans are compatible with the decarbonisation trajectory necessary to be Paris-aligned. Reference to the Paris agreement – albeit indirect – is only included in relation to an entity's climate-related targets (see paragraph 23(e) of IFRS S2) but is absent from the disclosure requirement of the transition plan. This implies that – should the climate target differ from the Paris Agreement targets, which is entirely possible in the draft ISSB standard – the user would not be in the position to assess an entity's transition plan against known pathways and notably to understand whether or not it is Paris aligned. This also means that the transition plans of companies with different climate targets would not be directly comparable given that they would reflect different climate targets as chosen by each entity. The ECB is of the view that the disclosure requirement should be reformulated to ensure comparability and permit direct assessment of the compatibility of an entity's transition plan with the transition to a climate-neutral economy and with limiting global warming to 1.5 °C in line with the Paris Agreement.

- **The draft standard should require both absolute and relative GHG emissions reduction targets.** Paragraph 23(c) of Exposure Draft IFRS S2 allows entities to decide whether to disclose an absolute target or a relative intensity target. The ECB considers it important that both absolute and relative GHG emissions reduction targets are required for all entities: absolute targets are an essential metric to assess progress towards climate mitigation, while relative targets are key for comparability purposes. Allowing entities to choose between absolute and relative emissions reduction targets reduces transparency and creates potential for confusion. It would notably hamper comparability between firms that decide to adopt different types of targets.

- **The draft standard should require the disclosure of intermediate climate targets.** Paragraph 23 of Exposure Draft IFRS S2 requires entities to disclose any milestones or interim targets, without however prescribing any fixed intermediate targets. The ISSB should consider requiring key fixed intermediate milestones, such as targets for 2030 and 2050, to enable horizontal comparability and an assessment of how progress achieved by individual entities compares with the high-level policy commitments of the jurisdictions concerned. Furthermore, the ECB considers that the ISSB should consider additional guidance on how and when targets should be updated, and, as a minimum, ensure transparency in terms of how entities should disclose progress when these targets are updated over time. Without such additional guidance, there is a risk of moving goals posts, which would make information on progress towards a given target potentially misleading.

- **The disclosure of GHG emissions reduction targets should exclude the use of offsets**. Paragraph 13(b)(iii) of Exposure Draft IFRS S2 permits the inclusion of offsetting in disclosures of GHG emissions reduction targets. The ECB appreciates the proposed additional disclosure requirements for the use of offsets, which would provide users with important information on a potentially misleading aspect. However, it is of the view that the main GHG emissions reduction targets should be disclosed net of offsetting. The ECB considers that compensating for actual GHG emissions with carbon offsets would make the GHG emissions targets less transparent, possibly misleading, and generally less credible. The use of offsets should be understood as a residual complementary measure which should not take precedence over, or distract attention and resources from, tangible efforts to reduce emissions. The use of offsets, and their estimated contribution to GHG emissions removal, should instead be disclosed separately from the climate targets, excluding altogether non-certified offsets whose actual contribution cannot be ascertained, and subject to a conservative assessment of their impact.
- **The draft standard should require disclosure of energy consumption**. IFRS S2 does not require disclosure of energy consumption in the main text of the standard, and specific requirements on energy use are only included in Appendix B for some, but not all, industries. This approach seems unjustified given the relevance of information on energy consumption: even from a narrow enterprise-value perspective, this information is highly relevant, as it permits direct assessment of the financial impact of changes in energy prices, as well as of an entity’s vulnerability to energy supply disruptions – which, as the current geopolitical environment shows, can have substantial impacts on business resilience and financial performance. Furthermore, the choice of which industries in Appendix B are subject to the requirement seems inconsistent and arbitrary. The ECB is of the view that this requirement should be introduced in the standard for all entities, including a breakdown between renewable and non-renewable energy. Disclosures of non-renewable energy should be further broken down by energy source (coal, oil, gas, etc.).
- **The presentation of Scope 1, 2 and 3 emissions should be standardised** to improve accessibility and comparability. Currently Paragraph 21(a)(i) of Exposure Draft IFRS S2 does not prescribe a given format for the presentation of GHG emissions data, nor does it require their disclosure in comparison with the corresponding targets and baseline. This hinders the readability of the information and its comparability across entities. The ECB considers that disclosures of Scope 1, 2 and 3 emissions should be provided in a mandatory tabular format, including information on progress towards the targets and comparison against the baseline year. Furthermore, the ECB encourages the ISSB to standardise the Global Warming Potential

(GWP) factors to be used in calculating these emissions based on those defined by the Intergovernmental Panel on Climate Change.

- **The ECB appreciates the detailed guidance on scenario analysis** provided in IFRS S2, Paragraph 15(b), on how the analysis of the climate resilience of an entity has been conducted, including on the assumptions and methodologies used. The ECB welcomes the high degree of transparency required in terms of the scenarios used to perform this analysis, including the requirement to explain *why* a given scenario was chosen. The ECB would, however, encourage the ISSB to include additional explicit references to key recommended baseline scenarios for assessment of the physical and transition risks in order to provide entities with clearer guidance on which scenarios to adopt. For physical risks, a high emissions scenario should, in principle, be used. For transition risks, an emissions pathway consistent with limiting global warming to 1.5 °C, in line with the Paris Agreement, should be used. Explicit reference to the scenarios developed by the Network on Greening the Financial System (NGFS) could be included for both cases.

3. Disclosures for credit institutions

Improved corporate disclosures are key to enabling credit institutions (and financial institutions more generally) to understand and better manage climate-related risks, as well as to give the financial sector access to reliable sustainability information to inform financing decisions in line with each institution’s sustainability strategy. But credit institutions are not only users but also preparers of sustainability disclosures. Hence, reliable disclosures by credit institutions are also key to enabling market participants to understand how banks are identifying and managing climate-related and other sustainability risks, thereby supporting market discipline. Against this background, the ECB welcomes the ISSB’s aim to complement its cross-industry standard with the additional metrics specific to the financial industry included in Appendix B of SFRS S2, and would like to make the following comments:

- **Financed emissions are especially relevant among sector-specific disclosures for the financial sector and the ECB fully supports their inclusion as part of the requirements**. At the same time, the broad range of existing GHG emissions allocation methodologies could hinder comparability of the figures that are disclosed by each entity. As stated in the Basis for Conclusions on IFRS S2, the Partnership for Carbon Accounting (PCAF) Standard builds on the GHG Protocol rules and is already widely used in the financial industry. The ECB would therefore support clearer reference in the financial-sector standards of Appendix B to the PCAF methodology for the calculation of financed emissions, while being mindful that this approach still allows for some flexibility, notably as regards Scope 3 financed emissions, which should therefore be disclosed separately. It would be useful, in this regard to complement the headline figure with a disclosure of the share of GHG financed emissions that are based on reported emissions (collected directly from the borrower or investee company) and those that are estimated, together with an indication of the methodology used.
- **Additional information on the energy efficiency of financed real-estate would be useful**. Specifically in relation to the commercial banks and mortgage industry standards in Appendix

B, the ECB considers that additional quantitative disclosures, such as disclosure of the average energy efficiency of mortgages in terms of kWh/m², might be particularly useful for understanding the transition to efficient and decarbonised building stock.

- **Ensuring global consistency of bank-specific sustainability disclosures is of crucial importance.** The ISSB sector-specific standard should be aligned with existing jurisdictional regulatory Pillar III disclosures to avoid any inconsistency and double reporting. In this regard, it is noted that a Pillar III disclosure requirement already exists in the European Union for banks on ESG risks that also incorporates climate information[1]. Furthermore, principles for Pillar III disclosures for banks are being developed in parallel at international level by the Basel Committee on Banking Supervision (BCBS)[2]. In the light of this, the ECB strongly encourages limiting possible differences in the definition of banks' specific risk metrics that might overlap with regional and international initiatives. Such inconsistencies might hinder the interoperability of the sectoral standards for credit institutions. Given the ongoing processes, the ECB recommends close cooperation between the ISSB and the BCBS, and more generally recommends that the Appendix B standards for the financial sector undergo a more thorough process of due diligence and consultation with international and jurisdictional financial-sector authorities.

4. Additional comments

The ECB would like to take the opportunity to provide a few additional technical comments, aimed at improving the reliability, comparability and overall quality of the ISSB standard.

- **The ECB considers that the ISSB standard could benefit from additional guidance on how entities should conduct the assessment in order determine what information is material** in terms of enterprise value ("materiality assessment"). In particular, further guidance seems necessary for companies to be able to determine how their enterprise value could be affected by sustainability-related risks and opportunities. To ensure consistency, comparability and verifiability of the information concerned, it might be also useful to require disclosure of the assessment and the processes that the reporting entity has followed in determining the information that is material, together with any thresholds used.

- **The ECB is of the view that the ISSB should provide a clear definition of the short, medium and long-term time horizons** used throughout the standards. Paragraph 18 of Exposure Draft IFRS S1 intentionally refrains from providing a definition of the time horizon concepts used. The ECB considers that clear and standardised definitions of time horizons are necessary to ensure comparability and ensure transparency in terms of how sustainability risks are expected to influence enterprise value. In this regard, the following references might be

1 See *Final report: Final draft implementing technical standards on prudential disclosures on ESG risks in accordance with Article 449a CRR* (EBA/ITS/2022/01), European Banking Authority, Paris, 24 January 2022.

2 See *Basel Committee supports the establishment of the International Sustainability Standards Board – Press release*, Bank for International Settlements, Basel, 3 November 2021.

used: (a) one year for short term;(b) two to five years for medium term; and (c) more than five years for long term.

5. Alignment with the European Sustainability Reporting Standard (ESRS)

The development of the ISSB standards is occurring at the same time as the EU adoption of the Corporate Sustainability Reporting Directive (CSRD) and the related development of a draft European Sustainability Reporting Standard by the European Financial Reporting Advisory Group (EFRAG). In its legal opinion on the CSRD proposal, the ECB called on the ISSB to construct its sustainability standard together with EFRAG to ensure alignment and compatibility between the ISSB and EU standards[3]. In this regard, the ECB welcomes the past and ongoing technical cooperation between the ISSB and EFRAG and calls on both organizations to continue and intensify their bilateral interactions to ensure the closest possible alignment between the two standards. The cooperation between the two standard-setters should be a two-way process whereby both the ISSB and EFRAG learn from each other and adjust their respective standards with the aim of achieving a mutually beneficial process of upward convergence.

The ECB appreciates that – as a result of these interactions – the draft ISSB and EFRAG climate standards already display a good level of overlap in terms of high-level disclosure requirements: in particular, the ECB welcomes the fact that the requirements in the ISSB climate standard (IFRS S2) are all broadly reflected in corresponding requirements in the EFRAG standard (ESRS E1). This high-level correspondence is essential to ensure that compliance with the EU standards ensures at the same time compliance with the (narrower) ISSB disclosure requirements. This high-level correspondence should be reflected at the granular level of each individual reporting requirement to entirely avoid the risk of double reporting.

The ECB is, however, concerned by certain inconsistencies between the two climate standards, most notably in relation to the definition of GHG emissions reduction targets, transition plans and use of offsets. In line with the ECB expectation of a mutually beneficial process of upward convergence, the ECB encourages the ISSB to benefit from the advanced requirements proposed by EFRAG (ESRS E1) in relation to transition plans and climate targets, consistently with the comments referred to in Section 3 above. On the other hand, the ECB encourages EFRAG to draw from the ISSB (IFRS S2) example in relation to the high degree of transparency of how physical and transition risks are estimated.

ISSB-EFRAG cooperation should build on the good degree of overlap already achieved and identify remaining issues where alignment is insufficient and there is a risk of inconsistencies. The ultimate goal should be an alignment that is as close as possible between the two standards, while remaining mindful of the fact that the EFRAG standard – as per the CSRD legal text – is, by design, broader that of the ISSB, given its double materiality perspective and that it provides information for a

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3 See Opinion of the European Central Bank of 7 September 2021 on a proposal for a directive amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting (CON/2021/27) 2021/C 446/02) (OJ C 446, 3.11.2021, p. 2).

larger group of stakeholders. The ECB considers that it of the utmost importance that – where full alignment is not possible or desirable between the ISSB and regional/national standards – clear reconciliation tables are provided to users to ensure interoperability and avoid double reporting. To this end, the ISSB should consider conducting, jointly with regional/national standard-setters (including EFRAG), mapping exercises of national/regional standards against the requirements of the ISSB draft standards. The Sustainability Standards Advisory Forum could notably be tasked with producing formal reconciliation tables that could then be jointly endorsed by the ISSB and regional/national standard-setters, thus providing a consensual basis for mutual recognition of (parts of) the ISSB and regional standards.

6. Way forward

As expressed in its opinion on the CSRD proposal, the ECB reiterates the view that any international standard should cover all aspects of sustainability. In this spirit, the ECB calls on the IFRS foundation and the ISSB to consider the draft standards under consultation as a first step and reconfirm their ambition to continue working to extend the standards to ultimately cover all aspects of sustainability. In this regard, the ECB notes that the current lack of topical ISSB standards beyond climate and the corresponding discretion for entities to disclose sustainability information under IFRS S1 provide an incomplete global baseline for comparable sustainability disclosures. The ECB urges the ISSB to define the universe of sustainability-related disclosure topics more clearly and replace the catch-all IFRS S1 with targeted topical standards covering all aspects of sustainability.

Finally, the ECB reiterates that – to meet users' expectations – any international standard should require companies to disclose not only issues that influence enterprise value, but also information on the company's broader environmental and social impact ('double materiality'). While appreciating the dynamic understanding of materiality adopted in the ISSB climate standard, the ECB reiterates its support for the concept of double materiality embedded in the EU legal framework, and highlights the fact that properly reflecting impact materiality in sustainability disclosures is essential to fully meet the rapidly evolving information needs of investors, as well as those of consumers, citizens, policymakers and society at large. The ECB stresses that the impact materiality perspective should be expected to become increasingly relevant as sustainability disclosures are extended to cover other sustainability topics beyond climate. The ECB encourages the ISSB to continue reflecting on its materiality approach and regularly assess appropriateness of that approach to meet the needs of users.