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IFRS Foundation Satellite
Office
Opernplatz 14
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Ref: ISSB's Exposure Drafts 'IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information' and 'IFRS S2 Climate-related Disclosures'

Dear Mr Faber,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to respond to the ISSB's Exposure Drafts ED/2022/S1 *IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information* and ED/2022/S2 *IFRS S2 Climate-related Disclosures* (referred to collectively as the 'EDs'). We are pleased to provide you with the following comments with the aim of contributing to the development of a high-quality set of international standards for corporate reporting on matters relating to Environmental, Social and Governance (ESG) aspects.

As part of ESMA's mandate to consider sustainable business models and ESG-related factors across the different areas of legislation within our remit, we have observed in the past years the growing interest by financial market participants, as well as by other stakeholders in more relevant, reliable and comparable disclosures relating to ESG factors (hereinafter referred to as 'non-financial information' or 'sustainability reporting').

European legislation in the area of sustainable finance has given further stimulus to the market demand for sustainability reporting. Subject to the finalisation of the Corporate Sustainability Reporting Directive (CSRD), steps are underway to set up a comprehensive set of European Sustainability Reporting Standards (ESRS) that aims at addressing this demand while taking into account some key specificities of the European context, most notably: the need to cover the entire spectrum of ESG topics, the importance of the 'double materiality' principle and the need to be consistent with major pieces of sustainable finance legislation, such as the Taxonomy Regulation, the Regulation on sustainability-related disclosures in the financial services sector (also referred to as 'SFDR') and the Regulation on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds (also referred to as 'Benchmarks Regulation').

While ESMA fully supports and actively contributes to these EU efforts, we note the need to ensure the better flow of information across the sustainable investment chain including for SMEs, as recently highlighted by the G7¹, and to effectively support the shift towards a more sustainable economic and financial system not only within the EU, but also at global level. To this end, in ESMA's view, it is necessary that regional standardisation, most notably in Europe, and international efforts go hand-in-hand. Both efforts should enable a target scenario where issuers can rely on high-quality reporting standards which are consistent, interoperable and as much as possible global and, where necessary, regional or jurisdiction-specific.

From this perspective, as indicated in our December 2020 and July 2021 responses respectively to the IFRS Foundation's Consultations on Sustainability Reporting² and to the Exposure Draft on Targeted Amendments to the IFRS Foundation Constitution to accommodate an International Sustainability Standards Board (ISSB) to set IFRS Sustainability Standards³, ESMA welcomes the IFRS Foundation's initiative to consolidate some of the existing standard-setting and framework initiatives and we strongly support the work of the ISSB to reach a common set of internationally accepted high-quality sustainability reporting standards which could serve as a global baseline.

ESMA believes that the EU standard-setting work on corporate sustainability reporting and the work of the ISSB can progress on reaching a common ground on three main areas: (i) basic elements of the standard-setting process such as the architecture of the requirements, the reporting boundaries and, where possible, the terminology; (ii) the disclosure requirements for information on material risks and opportunities from the perspective of enterprise value creation; and (iii) the approach for the identification of sustainability-related impacts that reporting entities generate on the environment and the people. Some of these impacts will then be captured by the EU reporting requirements from the 'impact materiality' perspective and others will feed both the EU and ISSB reporting requirements through the enterprise value creation perspective. In this respect, ESMA encourages the ISSB to work closely with the European Financial Reporting Advisory Group (EFRAG) on those three areas and, particularly for the impact materiality perspective, to facilitate tripartite technical discussions involving also the Global Reporting Initiative (GRI) which has for many years been setting standards to reflect sustainability-related impacts. Such discussions should also ideally result in a mapping of the ISSB requirements vis-à-vis those of EFRAG and GRI (and of any other relevant jurisdiction-specific initiative).

In this respect, ESMA believes that the ISSB can play an important role in aggregating the relevant players and help building an internationally agreed baseline of sustainability reporting standards that takes into account both risks and opportunities through the ISSB standards, as well as impacts through the EU and other international initiatives.

¹ [G7 Finance Ministers and Central Bank Governors' Petersberg Communiqué](#) – 20 May 2022

² [ESMA32-334-334](#) - Response to Consultation Paper on Sustainability Reporting – 16 December 2020

³ [ESMA32-334-419](#) - Response to Exposure Draft on Targeted Amendments to the IFRS Foundation Constitution to accommodate an International Sustainability Standards Board to set IFRS Sustainability Standards – 21 July 2021

The need for setting up such a comprehensive baseline in the interest of investors is simple and intuitive: the risk of greenwashing in the sustainable investment chain largely stems from claims that often have to do with alleged societal and environmental positive impacts of certain financial products or entities. Such claims do not necessarily distinguish between ‘enterprise value creation’ and ‘impact materiality’. As a matter of fact, a vast part of the new incoming legislation in Europe, but also in other jurisdictions around the world, is aimed at tackling the causes of this detrimental phenomenon for investors. These initiatives are targeted at protecting investors from the perspective of both risks and opportunities as well as impacts. It is, therefore, important that in the corporate disclosures domain the impact perspective is also adequately captured.

This is why ESMA, also through our active participation in IOSCO, strongly supports not only the work of the ISSB, but also the collaboration set up between the ISSB and GRI to ensure good international convergence between financial materiality and impact materiality and the work with the Jurisdictional Working Group as a key initiative to help drive the necessary set-up of a comprehensive and truly interoperable standard-setting solution for sustainability reporting. Lacking such a solution, we face the risk of a continued fragmentation of the sustainability reporting landscape with increasing costs and risks for the investment community as well as issuers operating internationally, and ultimately more difficulties to give effect to the much-needed sustainability transition.

In light of these considerations, when assessing the proposals in the EDs, ESMA has looked at two main aspects: (i) the suitability of the proposed requirements to serve well the information needs of investors, in particular those that operate in EU markets and are subject to EU-specific disclosure obligations; and (ii) the potential for convergence of the ISSB proposed requirements with the draft ESRS developed by EFRAG and which are currently undergoing a public consultation until 8th August 2022. As a result of ESMA’s analysis, let me emphasise five key areas on which we suggest to reconsider the proposed requirements prior to the finalisation of the standards.

Firstly, regarding the notion of ‘sustainability-related’ financial information, the proposals do not define what are the sustainability-related matters addressed in the standards. ESMA would recommend selecting a converged scope and definition of what is meant by ‘sustainability’ with other major standard-setting initiatives.

Secondly, regarding the overall approach to materiality, we recommend that the terminology relating to the identification of risks and opportunities be clarified and made consistent across the standard (e.g., the use of terms such as ‘significant’ and ‘material’). Furthermore, ESMA recommends that the role of external ‘impacts’ in assessing enterprise value creation is better clarified and, ideally, made consistent with the impact identification process of other standard-setting initiatives, such as ESRS in Europe and GRI standards internationally.

Thirdly, on the use of entity-specific disclosures and metrics, the ISSB envisages the possibility of individual issuers determining their own metrics and disclosures either to complement those already envisaged by an IFRS sustainability standard or to make up for the lack of specific requirements in relation to a certain matter. It is important to ensure that such entity-specific

metrics do not result in confusion for investors and, therefore, cases in which such metrics could qualify as 'adjusted' versions of those mandated by the individual ISSB standards should be accompanied by adequate disclosures. In this respect, we suggest considering as examples of such possible disclosures the requirements in ESMA's Guidelines on Alternative Performance Measures⁴ and the accompanying Q&As⁵.

Fourthly, with respect to the use of sector-specific guidance from SASB, we recommend that the ISSB consider how to introduce such guidance as part of its mandatory requirements in the climate-reporting standard, taking into account three main aspects: (i) excluding parts of that guidance that is not necessarily related to climate; (ii) amending aspects of it that are not fully suitable for application in an international context given their jurisdiction-specific connotation in some cases; and (iii) considering a phased application of such requirements.

Finally, in relation to transition plans and emissions offsets in the draft climate-reporting standard, we recommend complementing the requirements with some key additional details that are critical to achieve the comparability and relevance of reported information and improve the convergence with the draft ESRS proposals.

More detailed comments on the EDs are set out in Appendix to this letter. In case you have any questions or comments, please do not hesitate to contact me or Evert van Walsum, Head of the Investors and Issuers Department (Evert.vanWalsum@esma.europa.eu).

Yours sincerely,

signed

Verena Ross

⁴ [ESMA/2015/1415en](#) - ESMA Guidelines on Alternative Performance Measures – 5 October 2015

⁵ [ESMA32-51-370](#) - Questions and answers ESMA Guidelines on Alternative Performance Measures (APMs) – Last updated 1 April 2022

Appendix – Responses to specific questions

ED IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information

Question 1 (overall approach)

1. ESMA believes that the proposed requirements in IFRS S1 clearly address the need to identify all material information on the identified sustainability-related risks and opportunities and that the list of sources provided for in paragraph 51 of the draft standard will help complement the set of IFRS sustainability standards until it is complete.
2. We note, however, that the area of sustainability-related matters is not defined and therefore it would be helpful that IFRS S1 sets out a clear definition of 'sustainability'. In the current reporting debate, some draw a distinction between "ESG" and 'sustainability'. It would therefore be relevant to understand in what sense the ISSB refers to sustainability and which topics (e.g., biodiversity, pollution, marine resources, human rights, governance, etc.) in the wide ESG spectrum its standards intend to cover (either directly with an IFRS sustainability standard or, in the meantime, through the other sources listed in paragraph 51). ESMA would recommend selecting a converged scope and definition of what is intended by 'sustainability' with other standard-setting initiatives. ESMA also notes that in the ED both the terms 'sustainability-related financial information' and 'sustainability-related financial disclosures' are used with different definitions, however it would be beneficial to indicate what the purpose of this distinction is.
3. Furthermore, we support the incorporation into IFRS S1 of an Appendix with guidance on the qualitative characteristics of useful sustainability-related financial information that is based on the Conceptual Framework. However, it would be important to consider including in this Appendix also relevant guidance on the implementation of such characteristics and on the cost constraint (similar to that in the Conceptual Framework). In ESMA's view, more emphasis on the implementation of these qualitative characteristics will help issuers address the so-called 'disclosure problem' (i.e., the tendency of some issuers to focus more on a 'tick-the-box' approach when fulfilling the reporting requirements) which leads to information that is of limited relevance for investors.
4. One area on which clarity needs to be improved is the interplay between the Appendix B of IFRS S2 on industry-specific requirements derived from SASB and the list of sources in paragraph 51 of IFRS S1. While the latter is meant to point at possible sources of any risks and opportunities (and related disclosures) which may result in material information, the former is an appendix that is expected to be specific to climate disclosures, but it instead seems to relate, in some cases, to disclosure requirements that go beyond climate-related matters strictly speaking.
5. As it stands, Appendix B of IFRS S2 seems to be a much wider pool of disclosure requirements from which entities may select relevant disclosures also for other topics

on the ESG spectrum, such as marine resources or even about the level of activity of entities in the different sectors (e.g., when it comes to the number of plants, i.e., factories that an entity has).

6. While it is important to develop sector-specific requirements that cut across different sustainability topics, the level of specificity of these requirements, coupled with the fact that industry classifications vary across the world (e.g., EU classification would differ from the SASB classification), may make it necessary to introduce these requirements in a phased manner, so as not to hamper convergence at international level with other initiatives, most notably EFRAG in Europe and GRI which has for many years been setting standards at global level to reflect sustainability-related impacts. We would therefore recommend considering how sector-specific guidance could be included as part of the standards at this stage. Any sector-specific guidance should be considered as part of the broader task of building international convergence with other international and regional initiatives. In this respect, subject to other specific comments in relation to IFRS S2, we support the current approach to introduce relevant SASB guidance as an appendix to the climate standard rather than as standalone guidance and we would recommend that the ISSB follows the same approach for other future topic-specific standards.
7. ESMA would also like to flag one aspect that may impair the ability of enforcers and auditors to determine whether an entity has complied with the Standard, namely the use of the terms “significant” and “material” throughout IFRS S1 and S2. It would be important to understand the relationship between material information and significant risks and opportunities from a process perspective and how to distinguish what is material from what is significant, if any difference is meant to exist.
8. ESMA also notes that by focusing on sustainability-related risks and opportunities, the proposals in the EDs reflect well the TCFD approach. However, ESMA also notes that in assessing enterprise value creation, such risks and opportunities need to be put in the wider context of the entity’s purpose, business model, products and services and interaction with the value chain. To this end, ESMA would suggest that the ISSB consider how relevant content of the IFRS Foundation’s Practice Statement on Management Commentary may be incorporated into the sustainability reporting standards to complement the sustainability-related disclosures with relevant context, for example, a description of the business and of the external environment in which the entity operates, the entity’s main markets and competitive position, the main products and services, business processes and distribution methods, the entity’s structure and how it creates value. Where this information is presented elsewhere than in the sustainability report, it would be useful that appropriate cross-referencing to this information is made. This is because it would be important to ensure that sustainability-related information is set out in the broader context of an entity’s operations.
9. Finally, ESMA also recommends that the ISSB, together with other major standard-setting initiatives, such as EFRAG and GRI, engages in a joint mapping exercise of its general requirements and climate-related requirements with those of GRI and EFRAG respectively, in order to (i) clearly identify areas where convergence can still be built,

(ii) better understand areas of justified divergence, (iii) be able to explain those to the wider audience and (iv) assess areas of present and possible future compatibility. More generally, consistency in architecture and terminology between the ISSB's general and climate-related requirements and other major standard-setting initiatives should be achieved as far as possible when the underlying concepts are meant to be the same. Similarly, when the same data points and narrative information are meant to be requested under the ISSB and other standards, the terminology used for those common disclosure requirements should be as aligned as possible.

Question 2 (Objective)

10. ESMA generally supports the proposed objective for IFRS S1. However, ESMA notes that the text in paragraph 1 refers to the usefulness of the information to the primary users both to assess enterprise value *and decide whether to provide resources to the entity*. Whereas the definitions of sustainability-related financial disclosures and information in Appendix A only refers to 'assess enterprise value' and no reference is made to the fact that users will use this information to decide whether to provide resources to the entity.
11. As set out in response to Question 1 (Overall approach), we would suggest defining in Appendix A what is meant by 'sustainability'. ESMA would also suggest clarifying the difference between 'sustainability-related financial disclosures' and 'sustainability-related financial information' and the relationship between those two terms and what is the intended outcome in setting out this distinction. Furthermore, in relation to paragraph 3 which relates to an 'accurate depiction' of an issuer's sustainability-related financial information, we suggest that the ISSB consider replacing this wording with the terms 'free from error' which seem to be better aligned with the Conceptual Framework,

Question 4 (Core content)

12. In general, the description of the objectives for each of the core content parts on Governance, Strategy, Risk management and Metrics and Targets are clear.
13. In relation to Governance, we would suggest the following improvements:
 - a) In paragraph 13.b, we suggest issuers are also required to disclose what the key responsibilities of the governance bodies and management bodies are (not only how these are reflected in the terms of reference or board mandates).
 - b) In paragraph 13.d, we suggest that issuers are required to disclose for what purpose governance bodies are informed, in addition to information on how and how often this information is provided.
14. In relation to Strategy:
 - a) In paragraph 15, the ISSB should consider explaining how the notions of 'business model' and 'strategy' relate to the notion of 'enterprise value creation'. For example, in paragraph 15.b the ED requires disclosure of the effects of significant sustainability-related risks and opportunities on its business model and value chain. However, this information would be useful only if

complemented by disclosures illustrating the business model and value chain of the entity which, as mentioned in paragraph 7, IFRS S1 does not require.

- b) In paragraph 17 we suggest that it may be useful to define 'resources' since, in the context of sustainability reporting, this notion could diverge from the notion of 'Economic resources' that is referred to in the Conceptual Framework.
- c) In paragraph 18, without defining strict time bands, it would be useful to provide more examples and guidance on the drivers that may help define the 'short, medium and long' term. It would also be important to ensure consistency with these notions as adopted in financial reporting.
- d) In relation to paragraph 20, we note that it could be difficult for issuers to retrieve information to monitor the risks and opportunities arising upstream across the value chain, especially when issuers do not control these suppliers. While issuers are expected to have sufficient knowledge of their counterparties in the supply chain to address any material risks and opportunities that may arise from the relationship with them, the Standard may need to provide examples to help assess such risks and opportunities, especially when direct information from the suppliers is not available. It is ESMA's view that the guidance on information gathering in relation to value chains and any possible alleviations allowed for in specific cases should be agreed upon and converged internationally as much as possible.
- e) In paragraph 22, it is stated that 'an entity shall disclose quantitative information unless it is unable to do so'. In ESMA's view, an issuer should be required to explain why it is unable to provide quantitative information and when the issuer discloses quantitative information it should always complement it with qualitative and narrative explanation.
- f) Paragraph 22(b) indicates that the period over which a significant risk that there will be a material adjustment to the carrying amounts is considered is limited to the next financial year. We note that this period may need to be extended, considering the nature of sustainability-related risks and opportunities and their longer tail than financial risks. For instance, it would be important to know which sustainability-related risks do not yet trigger recognition of financial impacts in the current period's financial statements or in the next period, but may do so in a longer and still reasonably estimable period under certain conditions (for example, if there is lack of action from companies to take measures to mitigate or prevent material environmental and/or social risks).
- g) In paragraph 22(c), examples are provided of the effects of current and committed investment plans on financial position - we would suggest that 'possible impairment of existing assets' be included as an example.
- h) In paragraph 23, it would be useful to specify that issuers have to be transparent on the main assumptions and uncertainties when disclosing the resilience analysis as these are key for an understanding of the disclosures and for their verifiability.

15. In relation to Risk Management, paragraph 26(a) requires issuers to disclose the processes they use to identify sustainability-related risks and opportunities. We suggest that the reference to 'material sustainability-related risks and opportunities' is added here or that in general the Standard clarifies upfront that when reference is made to sustainability-related risks and opportunities, only the material ones are referred to.
16. On Metrics and Targets, paragraph 28 indicates that issuers must include metrics that are defined in other applicable IFRS Sustainability Disclosure standards and metrics developed by the issuer itself. The metrics developed by the issuer can address either topics not yet addressed in the ISSB standards, or topics already addressed by ISSB standards. In the latter case, it is ESMA's view that the Standard should require additional transparency to ensure that adequate information is provided to investors on their definition and underlying calculation methodology. In this respect, we suggest considering as examples of possible disclosures the requirements in ESMA's Guidelines on Alternative Performance Measures⁶ and the accompanying Q&As⁷ which, for example, require the use of meaningful labels for the metrics disclosures and the reconciliation with any other (mandatory) metrics of which the entity-developed ones would constitute an 'adjusted' version. When entity-specific metrics constitute adjusted versions of any mandated ISSB metrics, transparency on that fact should be provided and care should be taken in ensuring that these metrics are not made more prominent than the metrics required by other IFRS Sustainability disclosure standards or those in paragraph 54.

Question 5 (Reporting entity)

17. ESMA supports the definition of reporting entity (i.e., mirroring financial statements boundaries). However, we would suggest clarifying the reference in paragraph 40 to associates as entities on which the reporting entity has control, as associates are not typically within the control perimeter of the issuer. It would be beneficial to draw a distinction between the reporting entity (whose perimeter should squarely match that of financial reporting consolidation) and the sustainability reporting boundary which may go beyond the reporting entity and include associates and value chains.
18. In general, in relation to paragraph 40, it is ESMA's view that issuers may have difficulty in providing information relating to value chains, and particularly suppliers, when they do not control these operators, which may impair the quality of the reported information. It would be important to envisage alternative mechanisms in an initial phase of the mandatory reporting for issuers to gather the necessary information when relevant data is not available directly from suppliers or is incomplete. Provisions in this regard could include the use of estimates (accompanied by appropriate disclosures on the nature and source of estimates/data and implementation guidance) and the list of material entities in the value chain for which information was not directly available and the reasons for this fact.

⁶ [ESMA/2015/1415en](#) - ESMA Guidelines on Alternative Performance Measures – 5 October 2015

⁷ [ESMA32-51-370](#) - Questions and answers ESMA Guidelines on Alternative Performance Measures (APMs) – Last updated 1 April 2022

Question 6 (Connected information)

19. ESMA supports the requirements to promote connectivity across the sustainability reporting and with other parts of the annual financial report, including the financial statements. However, in relation to paragraph 42, ESMA suggests that the Standard explicitly requires consistency, where possible, with assumptions and estimates used in financial statements for the same horizons as those used in the sustainability reporting and an explanation for the cases in which such consistency could not be achieved. Consistency should also be required with respect to the contents of the management report, for example on the business model and (impacts) on strategy.
20. ESMA also notes that part of the information requested in paragraphs 42-44 may already be part of the IFRS financial statements when there is an effective incorporation of climate-related matters in financial reporting. In this respect, we recommend that the Standard clarifies two aspects: (i) the disclosures on linkages between sustainability-related financial information and financial statements do not replace the need for adequate reflection of sustainability-related matters in IFRS financial statements; and (ii) entities should not duplicate sustainability-related information already present within the financial statements but rather make cross-reference to it when necessary to complement the sustainability information.

Question 7 (Fair presentation)

21. ESMA generally agrees with the proposed requirements to promote fair presentation of sustainability-related financial information. The ED indicates that fair presentation would require 'faithful presentation' of sustainability-related risks and opportunities. From this perspective, ESMA notes that it may be useful to complement the general requirements in paragraphs 48 and 49 to ensure that topic-related IFRS Sustainability Disclosure Standards could be more specific on the requested level of granularity for particular disclosure requirements, e.g., country-by-country reporting and breakdown per sectors of activities, when this additional granularity can help achieve a more complete depiction of sustainability-related risks and opportunities.
22. In paragraphs 51-54, the ED proposes a list of authoritative sources for the identification of significant risks and opportunities and the related disclosure requirements. However, it would be important to clarify whether issuers are expected to review each one of the listed sources of guidance in paragraph 54 and whether these sources are meant to be used in any particular order of preference (i.e., as a hierarchy of sources, for example in the order in which they are listed in the ED).

Question 8 (Materiality)

23. In addition to our comments in response to Question 1 in relation to the terminology, ESMA generally agrees with how the notion of enterprise value creation is set out in the ED. However, ESMA notes that investors interested in sustainability-related matters may also be interested in 'impacts' per se and not necessarily in connection with the ability of an investee company to preserve or increase enterprise value. ESMA also notes that lack of standardisation of the 'impact' side of materiality may contribute to the greenwashing noise that makes it more difficult for investors to target – when they

so wish – investments which are capable of having real-world sustainability impacts or that are assessing issuers which are on a path towards meeting certain sustainability objectives.

24. ESMA recommends that the ISSB considers providing guidance on how to perform materiality analysis. In particular, one specific issue of the materiality assessment process which requires clarification is the role of 'impacts' in the architecture of the draft IFRS S1. If not addressed, this issue may make interoperability with other reporting standards more difficult. The issue can be summarised as follows:
- a. impact materiality and enterprise value creation materiality are two intertwined concepts whereas impacts that issuers generate on people and environment may activate a feedback loop that ultimately affects enterprise value. In other words, some of the identified impacts will also be relevant from the perspective of enterprise value creation.
 - b. The identification process of *all relevant* impacts is well-structured and identified in GRI Standard #3 *Material Topics 2021*.
 - c. The identified impacts should then still pass through the "filter" of the risks and opportunities they pose to enterprise value creation.
 - d. In order to enable interoperability with initiatives looking at both enterprise value creation and 'impact materiality', it would be important, that this process for identifying all relevant impacts is as much as possible agreed upon internationally.
 - e. To this end, ESMA would make the following suggestions:
 - i. On the basis of the existing cooperation agreements, the ISSB continues to engage in discussions with GRI as well as with EFRAG to achieve a common understanding and deliver largely consistent requirements on the impact identification process. ESMA stands ready to contribute to these discussions at technical level; and
 - ii. IFRS S1 to spell out this process for identifying impacts and then filtering them through the enterprise value creation lens more clearly.
25. ESMA also notes that it would be useful if, in addition to those in paragraph 6, the Standard would list other examples of potentially material sustainability-related topics which should be referred to as non-exhaustive. This list of examples should complement a definition of 'sustainability-related matters' that, as indicated in our response to Question 1, would be necessary.
26. The materiality approach chosen by the ISSB will focus only partially on the so-called 'impact materiality' and only to the extent an entity's external impacts result in risks and opportunities that are relevant to enterprise value creation. It is important that the existing cooperation with GRI and, as part of the jurisdictional working group, with EFRAG focuses on practical convergence mapping which can help building interoperability of the respective standards. Ultimately, the users of sustainability-related information will be interested in relying on a comparable, reliable and relevant

set of disclosures and it would be important that it is clear how the different standards and resulting information compare with and complement the others.

27. Lastly, in paragraph 57 the ED provides an example of material sustainability-related risks and opportunities with high impact but low probability outcomes. It may be important for investors, however, to also have information about high-probability events which trigger risks and opportunities such as the impacts of climate change which may have a low (or moderate) impact on an entity thanks to the mitigation measures it has taken.

Question 9 (Frequency of reporting)

28. ESMA generally supports the guidance on frequency of reporting.

Question 10 (Location of information)

29. ESMA recommends that, without preventing the use of other locations, the Standard indicates as the preferred location for the sustainability statements the management commentary. This will facilitate connectivity with the other information sitting in the management report, including those on an entity's purpose and business model.
30. In paragraph 73, ESMA suggests addressing the inconsistency between the definition in Appendix A of 'General purpose financial reporting' which does not include management commentary and the fact that one possible location envisaged in the ED for the sustainability-related disclosures is the management commentary.
31. In relation to paragraph 75, ESMA suggests requiring the disclosure of a table identifying where sustainability-related information is placed within the general-purpose financial reporting or in other documents through the incorporation by reference mechanism. This table would facilitate identifiability and accessibility of this information, help the digitalisation of the reporting and support the work of external auditors and enforcers.
32. Lastly, in relation to paragraph 75, ESMA believes that cross-referencing to other parts of the same annual report and to other documents should be allowed when these documents are published at the same time as the annual report and under the condition that the cross-referencing does not impair the understandability of the sustainability report as a self-contained set of information. ESMA also notes that the assurance implications of allowing extensive use of cross-referencing should be carefully considered. The ISSB should, for example, explain what 'same terms' means in the particular context of sustainability reporting and whether it is implied that information available on the webpage of an entity would be eligible for the cross-referencing. From a digital reporting perspective, ESMA suggests catering for cases in which cross-reference is made to external documents which are not normally part of the annual reporting package to ensure that when the sustainability report is conveyed in a digital format (e.g., XBRL), such cross-references point to the corresponding content. Ideally such content should be digitised in the same format and be made readily available.

Question 11 (Comparative information, sources of estimation and outcome uncertainty and errors)

33. ESMA generally supports the proposed requirements regarding comparative information, sources of estimation and outcome uncertainty.
34. Nevertheless, ESMA would recommend considering mirroring the distinction between adjusting and non-adjusting events as per IAS 10 *Events after the Reporting Period*, for information relating to transactions, events and other conditions occurring after the end of the reporting period. This distinction might be relevant especially for backward looking quantitative information included in the sustainability report. We would also recommend making reference in paragraph 83 to the fact that some specific IFRS sustainability standards may require sensitivity analysis, for example in the form of scenario analysis as per IFRS S2.
35. Regarding paragraph 84, the requirements on the disclosures of errors should be complemented by a definition of changes in policy and changes in estimate, as well as by a definition of the notion of 'impracticability'.

Question 12 (Statement of compliance)

36. In relation to paragraphs 91-92, ESMA is generally supportive of the proposed relief to provide certain disclosures that would otherwise be required by an IFRS Sustainability standard when such disclosures would be prohibited by local laws or regulations. However, ESMA considers it not appropriate to claim full compliance with the IFRS sustainability standards in the event that certain material information is not published due to national regulation. In this situation, ESMA rather believes that the entity should clearly state that it complies with the standard except for the omitted disclosure and the reason for not disclosing this information.
37. In particular, ESMA suggests requiring that when an entity applies such relief, it also clearly describes in the statement of compliance which of the required disclosures have not been provided and the source of the restriction.

ED IFRS S2 Climate-related Disclosures

Question 1 (Objective)

38. ESMA's comments relating to IFRS S2 more closely look at areas where inconsistencies might arise vis-à-vis the draft ESRS which are being consulted on at the time of drafting this letter to the extent that such differences may be relevant from the perspective of transparency towards investors.
39. The objective of the draft IFRS S2 appears aligned with the draft ESRS E1 objectives for the elements of it that relate to financial materiality. Importantly, both objectives refer to risks and opportunities arising from climate change and require that undertakings should disclose information that gives an understanding of the climate-related risks and opportunities that could affect their enterprise value, that shows how undertakings manage those risks and opportunities and that explains their ability to adapt to those risks and opportunities (though ESRS E1 additionally focuses on contributing to limiting global warming due to its double materiality lens).

Question 2 (Governance)

40. ESMA generally supports the proposed requirements on the governance related to risks and opportunities associated to climate-related matters and notes that these proposals appear well aligned with the requirements of ESRS E1.

Question 3 (Identification of climate-related risks and opportunities)

41. As indicated in our response to Question 4 on the IFRS S1 ED, ESMA generally supports the principles-based approach to the definition of the time horizon for reporting, however, it would be useful to provide in paragraph 9 examples and guidance on drivers that issuers are expected to use to select the relevant time-horizons to make sure that disclosure is comparable amongst different issuers.
42. The draft Standard in paragraph 10 says that when identifying significant climate-related risks and opportunities, companies should refer to the disclosure topics defined in the industry disclosure requirements in Appendix B. Mirroring the proposed requirement in paragraph 61 of IFRS S1, it would be useful to add a sentence to clarify that companies should disclose all information which is needed for users to understand their significant climate-related risks and opportunities, regardless of whether the information is mentioned in the appendix.

Question 4 (Concentration of climate-related risks and opportunities in the value chain)

43. ESMA generally supports the proposed requirements relating to value-chain and notes that they appear consistent with those of the draft ESRS (distinction between actual and potential risks and opportunities, description of where in the value chain risks and opportunities are concentrated, qualitative disclosure).

Question 5 (Transition plans and offsets)

Transition plan:

44. Generally, ESMA notes that while the draft basis for conclusions of the ED refer to specific elements of the transition plans, the actual proposed requirements in paragraph 13 seem not to include some of them, most notably the aspects referred to in paragraph BC73 about the target dates, scope and coverage, as well as the assumptions and uncertainties underlying the plans. While some of these elements are captured in relation to the changes needed to the business model to deliver on the plan (paragraph 13(a)(i)), ESMA suggests introducing the above-mentioned elements in more general terms as key elements of the transition plan disclosures.
45. Given the key role that transition plans play in helping investors understand the trajectory of issuers' claimed efforts to reduce their exposure to climate-related risks and their contribution to the deterioration of the climate system, ESMA believes that transparency around transition plans is key to contrast greenwashing. As such, ESMA suggests that paragraph 13 requires disclosures to explain the absence of a transition plan in case an undertaking does not have a transition plan, in particular highlighting how this is consistent with the fact that the entity has identified material risks and opportunities arising from climate-related matters. ESMA also recommends that in the definition of 'transition plan' (in Appendix A), the ISSB requires more clearly that the absolute GHG emission reduction actions constitute a minimum requirement of such plans. This is because an issuer with a plan to reduce its GHG emission intensity only, with no intended GHG emission reduction in absolute terms, should not be able to label its plans as a 'transition' plan. Another example would be an issuer whose plan only includes actions outside of the value chain such as avoided emission targets or offsetting targets and no plan related to emission reduction within the value chain. Finally, we also suggest requiring disclosure in paragraph 13 of the gross GHG emission reduction target set in accordance with the transition plan.
46. We also observe that transition plans in IFRS S2 are more closely linked to addressing climate-related risks and opportunities whereas in the draft ESRS E1 they have the aim of providing transparency on how entities contribute to limiting the average increase of global temperature to 1.5°C compared to pre-industrial levels. Since according to available climate science today, any GHG emission reduction target that is consistent with a global temperature increase scenario of more than 1.5°C would be sub-optimal from a sustainability perspective, IFRS S2 may need to require disclosures in that regard that could adequately warn investors to the extent this is relevant from an enterprise value creation perspective.

Offsets:

47. Ensuring that investors have adequate information about the role that offsetting plays in climate targets is key to combat greenwashing. In ESMA's view, this is one area where the level of transparency proposed by EFRAG's draft requirements could be a good reference point to increase also the level of relevance and transparency of the information resulting from the application of the ISSB standards. In this respect, while both IFRS S2 and ESRS E1 require companies to report their gross GHG emissions

(i.e., without any offset efforts), IFRS S2 permits companies to count offsets in achieving their GHG emission reduction *targets* which is not permitted in ESRS E1. ESRS E1 distinguishes between different climate related targets and it does not allow offsets to be counted against GHG emission reduction targets, but it provides for reporting of use of credits against GHG neutrality claims. This difference in the approach to targets could lead to differences in the information that users receive under IFRS S2 and ESRS E1: as IFRS S2 permits companies to ‘net’ their GHG emissions with offsets to compute their targets, targets may appear more ambitious than non-netted targets by companies disclosing under ESRS E1. This could be confusing and give an artificially positive impression of companies’ targets under IFRS S2 as compared to under ESRS E1. We would encourage the ISSB to seek alignment with EFRAG in respect of the treatment of different targets, distinguishing between emissions reduction targets and GHG neutrality targets. In addition, it would be useful to explain in application guidance that offsetting and GHG emission reduction in the value chain are two actions of different nature and that these are to be presented separately, including in target-setting, in particular to recognise their distinct added value/utility to mitigate climate change.

48. IFRS S2 permits companies to use offsets that are not certified. ESMA notes that offset programmes have been heavily criticised for lacking credibility or integrity (overestimating emissions reductions or removals, double counting, lack of permanence of the emissions reductions or removals, etc.). Certification can help address these problems. Requiring that companies report on offsets which are certified would additionally bring IFRS S2 closer to ESRS E1, especially if IFRS S2 would also require companies to disclose how big a part of their offsets are linked to different certification schemes (paragraph 13(b)(iii)(2)).
49. Furthermore, when companies do decide to use offsets that are certified, IFRS S2 does not establish any standards for the certification. While certification is a useful way to address concerns with offset programmes, even some certification schemes have been subject to criticism. Therefore, it would be useful to require that the certification schemes used are subject to an explanation of their qualitative characteristics, for example by using a definition along the lines of that applied by EFRAG (ESRS E1, Appendix A). Using this definition would have the additional benefit of bringing IFRS S2 and ESRS E1 closer together.

Question 6 (Current and anticipated effects)

50. ESMA generally supports the proposed requirements to disclose the financial effects of climate-related risks and opportunities on a company’s financial position, financial performance and cash flows in quantitative measures.
51. However, we propose the following clarifications to paragraph 14:
 - a) being more explicit about whether the disclosure required under paragraph 14(a) is expected to be provided simply with cross-references to the financial statements;

- b) clarifying what the difference is between the information under 14(b) and the information in the financial statements, for example those required by IAS 1, para 125 (when IFRS are applied by the entity);
- c) requiring disclosure on the methodology issuers use for computing the anticipated effect under paragraph 14(c) and consider providing application guidance with regards to the possible methodologies; and
- d) adding that the information about changes over time in paragraphs 14(c) and 14(d) should distinguish between the short, medium and long term.

Question 7 (Climate resilience)

52. ESMA notes that IFRS S2 leaves room for companies to decide whether to use scenario analysis. While we acknowledge that scenario analysis may be challenging for some companies to prepare, the fact that it can be replaced by a different type of analysis de facto indicates that it is considered perfectly fungible with other types of analysis. Ultimately, this approach will impair comparability for investors. ESMA also notes that this will represent an area of divergence with the draft ESRS E1 which requires disclosures of climate scenario analysis and does not envisage any substitutes for it. If this approach is maintained, ESMA suggests requiring issuers that do not use scenario analysis to explain the reason why they were unable to do so.
53. IFRS S2 defines climate resilience as ‘the capacity to adjust to uncertainty related to climate change’ whereas the IPCC defines climate resilience as ‘the capacity...to cope with a hazardous event or trend or disturbance, responding or reorganizing in ways that maintain their essential function, identity and structure...’. Climate change and its consequences create an uncertain environment for companies, and in the face of this companies adjust by developing tools to identify, assess and plan for a wide range of possible future outcomes. However, the fact that companies account for the uncertainties in their governance and planning processes does not, in and of itself, provide information on their resilience to climate change. Such information needs to come from the company’s identification and assessment of its vulnerabilities and relevant adaptation solutions. To reflect this, ESMA would suggest the following adjustments to the proposed requirements in paragraph 15:
- a) require disclosing information that enables users to understand the resilience of not only their *strategy* but also their *business model* (paragraphs 15 and 15(a)(i));
 - b) require disclosing the adaptation solutions issuers plan to / may implement to enhance the climate resilience of their strategy and business model and the expected associated improvements to their climate resilience;
 - c) amend the definition of climate resilience in Appendix A so that it better aligns with the IPCC definition and focuses on a company’s capacity to cope with climate-related hazardous events, trends or disturbances, reorganising in ways that maintain their essential activities and assets. It would also be important to ensure that this definition is converged at international level; and

- d) clarify in paragraph 15(b)(i)(3) that it would be useful that scenarios used in scenario analysis could be associated with transition risks, physical risks or both.

Question 8 (Risk management)

54. ESMA supports the proposed requirements on risk management and notes that they appear consistent with those of the draft ESRS E1.

Question 9 (Metrics and GHG emissions)

55. ESMA notes that the proposed metrics do not address the company's energy consumption and mix of sources (except when assumptions in these areas are included in the climate resilience disclosures). However, specific metrics in these areas are included in the Appendix B for specific sectors (e.g., for Software & IT Services). Such metrics could be considered for inclusion in IFRS S2.
56. ESMA also suggests requiring more detail on companies' internal carbon pricing, such as critical assumptions used to estimate carbon prices, approximate current year GHG emission volumes covered by the scheme and scope of application of the carbon pricing scheme.
57. In general, ESMA suggests accompanying the required disclosures of metrics in paragraph 21 with implementation guidance to help consistent application of these requirements.

Question 10 (Targets)

58. ESMA notes that the proposed disclosure requirements related to targets do not identify the use of pre-defined timeframes. While this is consistent with a principles-based approach, ESMA highlights that the disclosure of GHG emissions targets with largely differing timeframes will undermine comparability and increase the cost of analysing various companies' performance goals across and within sectors.
59. One possible approach to anchor the disclosures of targets to common timeframes could be to hint at milestones adopted in other standard-setting initiatives. For example, ESRS E1 requires that GHG emission reduction targets are disclosed 'in five years rolling periods and at least include target values for years 2030 and, if available, for 2050'.
60. The use of common forward-looking reference points will facilitate the consolidation of the targets published by multiple companies for stakeholders such as financial institutions or governments. To support comparability, we would suggest adding wording along the following lines at the end of paragraph 23(g): 'For GHG emission reduction targets, the disclosures shall at least include target values for years 2025 and 2030, and, if available, for 2050. In addition, intermediary targets may be disclosed in five-year periods'.

61. ESMA notes that it would be important to more clearly require in paragraph 23 that issuers disclose the progress made towards the pre-set targets and potentially also whether this progress is in line with what they had planned.
62. Furthermore, notwithstanding our comments in relation to paragraph 13, ESMA suggests spelling out a dedicated requirement in paragraph 23 to disclose the share of carbon offsets used towards achieving the climate-related target, including the various sub-shares of offsets obtained under each certification scheme. Such transparency should be accompanied by a statement which clarifies for investors that offsets are not substitutes for emission reductions.
63. ESMA also suggests making it clear in paragraph 23(e) that while the Standard refers to 'the latest international agreement on climate change', this is only to keep the standard from getting outdated, and companies should mention the actual agreement when they make their disclosure (currently, this is the Paris Agreement).

Question 11 (Industry-based requirements)

64. ESMA refers to its comments set out in the response to Question 1 on the IFRS S1 ED. We consider that the extensive body of industry-based standards developed by SASB could help the ISSB to identify some specificities of each sector which should be included in appendices to the relevant topic-specific standards as it is proposed for IFRS S2.
65. ESMA notes that, in some cases, the list of topics addressed in the Appendix B seems to go beyond climate-related matters strictly speaking (e.g., addressing broader environmental and social risks of the entity and its value chains, such as marine resources or even about the level of activity of entities in the different sectors (e.g., when it comes to the number of plants that an entity has)).
66. Furthermore, while the IASB has amended the SASB standards, there are still elements that appear more suitable to a North American context than to use elsewhere, including in Europe. For example:
 - a. Product lifecycle environmental impacts, Metrics CG-AM-410a.2 refers to AHAM (Association of Home Appliance Manufacturers, a North American Association).
 - b. Metrics CG-BF-130a.1 refers to disclose the total amount of energy it consumed as an aggregate figure in gigajoules (Gj) while in Europe it is common to disclose this measure in MWh.

Question 13 (Verifiability and enforceability)

67. The proposed requirements in the draft IFRS S2 involve a significant degree of judgement and assumptions relating to developments of complex climate-related phenomena and their impacts on issuers. Enforcement challenges may therefore arise, in particular on the use of scenario analysis, the anticipated effects of significant climate-related risks and opportunities on companies' financial position, financial performance and cash flow over a short, medium and long term and certain data

requirements for the value chain. In these areas, ESMA reinforces the importance of transparency on the methodologies used and the related assumptions as well as the use of sensitivity analysis.

68. In addition, we refer to our comments in relation to IFRS S1 on the topic of incorporation by reference in relation to which some assurance concerns were expressed.

Question 14 (Effective date)

69. Since IFRS S1 sets out general requirements that are in part also necessary to prepare topic-specific disclosure requirements, ESMA recommends that the effective date of application for IFRS S2 is set at the same time as that of IFRS S1 and that this date is set in the near future as it would be important for companies to start providing this information in a comparable way as soon as possible.

Question 16 (Global baseline)

70. ESMA's comments in relation to convergence and interoperability with other major standard setting initiatives are set out in our responses to Questions 1 and Question 8 of the IFRS S1 ED and we have commented on the interoperability between IFRS S2 and the relevant draft ESRS under several other questions.

Question 17 (Other comments)

71. ESMA suggests considering whether the proposed requirements are proportionate for application by SMEs and to consider which adaptations may be needed.