IFRS Sustainability Disclosure Standards S1 and S2 Consultation Response.

Introduction

In 2020, when the IFRS Foundation sought views on the establishment of an International Sustainability Standards Board ("ISSB") and what its key functions should represent, the HSBC Bank (UK) Pension Scheme ("the Scheme", "we") set out our support for the introduction of globally recognised sustainability reporting standards. We now welcome the chance to respond to the draft proposals set out by the IFRS Foundation with respect to the development of sustainability and climate-related disclosure standards ("the Standards").

We are one of the largest UK corporate pension schemes, with about £36bn of assets across our Defined Benefit ("DB") and Defined Contribution ("DC") sections. We are governed by a Trustee Board that is highly conscious of sustainability challenges, the risks posed by climate change in particular and the importance of the transition to a more sustainable, lower carbon economy.

In 2021 the Trustee Board made a commitment to achieve net-zero emissions by 2050 or sooner, targeting an interim real economy emission reduction target of 50% by 2030 or sooner for our public equity and corporate bond mandates. In making this commitment, the Trustee Board has become a signatory of the Institutional Investors Group on Climate Change ("IIGCC") Paris Aligned Investor Initiative and makes use of its Net Zero Investment Framework as a basis for our net-zero investment strategy.

We were early adopters of the Taskforce on Climate-related Financial Disclosures ("TCFD") framework and have been working to implement the TCFD recommendations since 2018 when we made our first public disclosure. We have dedicated considerable focus to integrating climate-related risks and opportunities into our decision-making, and sustainability considerations are explicitly considered within our Statement of Investment Principles.

Given our size, climate and sustainability ambitions, and experience as a regular user of climate-related data, we believe we are well placed to share our views on the Standards. We recognise the difficulty that market participants face in calculating and disclosing robust climate- and sustainability-related data but are confident that the introduction of global Standards requiring comprehensive and, importantly, verifiable disclosures will be beneficial to ourselves and other asset owners in the future.

Summary of our position

We strongly support the principle of the IFRS Foundation's introduction of sustainability and climate-related disclosure standards however we have two principal concerns on the disclosure standards as currently drafted which are:

1. The focus to be on double materiality and not on enterprise value

We strongly believe that this is an omission and that the standards should facilitate an assessment by asset owners of the real world impact of corporate entities. If corporate entities are only obliged to disclose where it is "significant" and "material" then, when aggregated across an asset owner's portfolios, there is possibly an unquantified and potentially substantial risk exposure.

Universal owners need a double materiality lens to inform critical, long-term decision making. Many investors, including ourselves, adopt a 'Universal Owner' mind-set. Universal owners can broadly be characterised as investors with highly diversified and long-term portfolios that represent a slice of the global economy. Corporate practices that maximise enterprise value at the individual entity level can contribute to additional costs, or externalities, which can negatively impact the enterprise value of other firms in the portfolio. Universal owners seek more than just entity-level enterprise value to understand the value and risks faced by their total portfolio, including adopting a double materiality lens.

Asset owners need forward looking indicators. Enterprise Value is a backward-looking, lagging indicator which is unsuitable for the current needs of asset owners. Our experience with climate change has been that, notwithstanding the existence of SASB and GRI, it has needed the TCFD framework to radically change the climate reporting landscape and even now, adoption has been disappointing. It has needed, and still needs, very considerable investor pressure to secure the decision-useful information. The point at which that an entity concludes that an issue has reached enterprise value materiality levels is far later than the point at which investors need to understand the potential impact of an emerging issue. A failure to recognise this "double materiality" concept with respect to sustainability risks is likely to result in too narrow a focus being applied on sustainability risks, which is backward looking and only "one way" with respect to the impact of sustainability risks on an entity but not the impact of the entity on its external environment.

This forward-looking focus is important for us as an asset owner. A useful example is our pension Defined Contribution global equity fund which is our default strategies' growth phase investment fund. The index which this fund tracks has exposure tilts that reduce exposure to companies with high carbon emissions intensity and reliance on coal extraction and which also increases exposure to companies with a higher proportion of revenue from green sources. Our ability to develop this investment approach, which focuses on the impact of companies on communities and the natural environment to address other sustainability risks will depend on data being available which helps us understand the impact of entities on communities and the wider ecosystem.

Having a forward-looking lens is important to many investors, and especially pension schemes such as ourselves. This is from both a risk management perspective but also in how assets are managed across different generational cohorts of pension scheme members. For example, sustainability risks may initially manifest themselves on the planet and society first and are only experienced by an entity over time. In our experience, it is only once such a risk is experienced by the entity, for example through a negative impact, that it becomes assessed and potentially disclosed by the entity.

We regard the availability of such forward-looking information, including assessing alignment with the goals of the Paris Agreement, as critical to the assessment of potential impact on financial materiality. This type of information is not readily available, posing a problem for investors who are forced to rely on estimates and proxies as a result. The inability of key decision-makers to take the strategic action necessary to allocate capital in a way consistent with positive long-term climate and sustainability outcomes is a direct consequence of this problem. We are therefore firm advocates of the expansion of Standards intended to improve climate- and sustainability-related data quality and robustness.

Our final point on enterprise value relates to its definition and calculation methodology. It would be helpful to clarify the definition of "*enterprise value"* and we note that, for the purposes of our 2021 TCFD Statement, we used the enterprise value including cash (EVIC) (sum of the equity and debt of the firm), as per the Partnership for Carbon Accounting Financials (PCAF) standards.

2. The lack of disclosure on how reported entities decide what is, and what is not, financially material

Investors require greater transparency on the entity's assessment of materiality and risk disclosures: The draft standards place considerable emphasis on an entity's risk management systems and processes to identify significant risks which require disclosure. This places significant reliance upon the entity's management and risk control systems to identify existing and emerging sustainability risks. There is no requirement for any disclosure of how an entity has reached a conclusion that no disclosure of a sustainability risk is required. This reliance means that investors have no information to assess whether that entity's risk management processes are sound, which has the potential to result in sub-optimal outcomes for entities and their investors. In BC 66 of the IFRS S1, the reason for not requiring a disclosure about how materiality assessments have been made is a concern that such disclosures may be boiler plate. We disagree with both the reason and the lack of required disclosure because we believe that entities should be held accountable for the information that they do not disclose because it may prevent investors undertaking a complete sustainability risk analysis of entities' business models.

Investors need disclosure of a wide range of sustainability-related information at an earlier stage than the entity's risk disclosure process requires: Reliance on the entity to decide and disclose only what it believes is material means that disclosures of sustainability information will be made only when an entity concludes it is material. This can be too slow for investors. Investors need disclosure of sustainability-related information at an early stage so that they can assess whether the risk is material for both that particular entity's business model and future cashflows, as well as having a potential impact on other parts of the portfolio. In practice, entities need to disclose a wide range of information about their impact on the planet and society so that investors, and especially those with a universal owner mind-set, can understand properly the risks associated with investing in that entity.

As a globally invested pension fund, we are acutely aware that the absence of a uniformly applicable standard for carbon and sustainability accounting and reporting presents a considerable barrier to the disclosure of financially-material data. Until there is a consolidation of reporting standards, the incentive to disclose this data is likely to remain weak, and widespread disclosure may not occur.
We believe the introduction of the proposed Standards will help remedy this issue, provided that the issues identified above are addressed.

We understand that the ISSB intends to build on SASB's industry-based Standards and that under these standards, entities are expected to report against all indicators for their respective industries. Whilst this potentially reduces the extent to which entities can self-define what is "financially material" our concern is that the SASB's standards may have insufficient scope to prevent significant amounts of material information remaining outside the disclosure requirements of those standards. Therefore, our preference is that the ISSB should provide clearer guidance on how materiality assessments should be undertaken and also to oblige entities to explain how their materiality assessments are undertaken. We believe that the ISSB should review and expand the list of issues that are currently identified by SASB as being material for each industry.

In relation to some of the specific proposals within the two consultations, we note the following points:

- **Disclosures aligned with the recommendations of the TCFD**: We believe the framework provided by TCFD is an effective lens to view climate-related risks and opportunities, and welcome its application to sustainability-related challenges as well. We note that the recently revised TCFD guidelines require that all companies should disclose their carbon emissions independently of a "materiality assessment". This requirement is not included in the draft IFRS S2. This is an example of double materiality at work as such disclosure of an entity's impact on the environment is important, as we have discussed above. We are concerned that disclosures of sustainability information may only be made when an entity concludes that the issue is, in its own view, material which could be too late for investors to assess the potential impact of nascent ESG issues on future cashflows and hence value.
- **Required disclosure of Scope 3 GHG emissions**: There remains a significant gap in reported Scope 3 GHG emissions data relative to Scopes 1 and 2 by corporate entities, meaning investors like ourselves are required to rely on proxies (where they are available) or indeed operate with incomplete information. Moreover, given the crucial role that sovereign bonds play in the investment strategy of DB pension schemes, it is important that we can make use of data that reliably captures these assets' associated GHG emissions. We

therefore strongly support the inclusion of this factor within the Standards and hope it will improve the reliability of GHG emissions data for both corporate and sovereign entities. We also note and commend the requirement to calculate and include both upstream and downstream Scope 3 GHG emissions.

- **The disclosure and verification of transition plans**: To achieve our net zero ambitions and fulfil our commitment as a signatory to the IIGCC, it is crucial that we can accurately measure the forward-looking transition alignment of our investment portfolio. In early 2022 we began the process of assessing the alignment with our intended net zero pathway, making use of the publicly available databases provided by the Science Based Targets initiative ("SBTi") and Transition Pathway Initiative ("TPI"). It was notable that coverage remains limited, and the universe often excludes the most at-risk companies, making this process somewhat challenging. We believe that the introduction of the Standards will increase the number of companies disclosing transition pathways and help us to construct and then monitor our own transition plan. We also welcome the IFRS Foundation's proposed requirement for preparers of climate- and sustainability-related data to seek third-party verification of their stated transition plans, as there has so far been limited global uptake to do so. We are cognisant that there remain existing practical challenges around verifying transition plans which will not be resolved immediately but are hopeful the Standards will help to accelerate the process for surmounting these challenges.

Concluding Remarks

We acknowledge this is the first iteration of the Standards and recommend below some adjustments to the draft Standards to help the IFRS Foundation in their goal of improving the availability of decision-useful data, thereby helping asset owners and companies make better-informed investment decisions to tackle the considerable climate and sustainability challenges facing the global economy. In particular, our suggestions are as follows:

- **Introduce a requirement enabling an assessment of double materiality**: Consistent with industry best practice our net zero objective includes a real economy emissions reduction target. This requires us to consider the impact that climate change could have on our investments and also the impact that our investments could have in combatting climate change via their impact on the real economy. This is an important point for us as investors, given the potential negative feedback loop impact on value should, for example, regulation move to price or restrict existing market externalities. Examples may include restrictions on the use of antibiotics in the pharmaceutical and agriculture sectors which contributes to antimicrobial resistance or the cost of biodiversity loss to the global ecosystem. In their current form, the Standards for climate-related disclosures do not consider this dual-aspect approach, instead focussing solely on the first impact channel. We think a move away from single materiality in the financial system to consider this double materiality approach is paramount to achieving the required improvements to deliver a more sustainable future and recommend the IFRS Foundation revisit their proposed disclosure requirements. The scale and urgency of the climate change challenge means that real world impacts by companies will rapidly have to be internalised into the economic system; disclosures which provide a window into this will provide investors with early insights into the likely financial and business impacts – and may also encourage companies to earlier action.
- **Encourage a broader focus on sustainability-related data, which are not limited to those impacting present enterprise value**: The Standards focus on the disclosure of climate- and sustainability-related data to facilitate a more complete understanding of an entity's enterprise value. However, asset owners do not use an entity's financial reports solely for assessing enterprise value; this information is crucial in considering the risk and opportunities presented by the sector in which the entity operates and determining what issues to engage with the entity on to discharge their stewardship and engagement obligations. We recommend the Standards take note of this fact and broaden their focus. It is also important that investors can understand the possible impact of a risk on investment and capital expenditure plans which TCFD requires. For example, an entity which is a heavy polluter may need to invest considerable amounts of capital expenditure to change its processes and this can be an important aspect of understanding the risks associated with both that entity and the sector within which it operates.

- **Signal the value of assurance and audit**: Investors welcome the confidence in reporting that comes from effective and robust assurance and audit. Assurance on sustainability remains in its nascency and we would urge the ISSB to maintain open dialogue with the IAASB to ensure that the Standards can over time be subject to appropriate assurance. We recognise that this is likely to require development over time. At least in the interim, investors gain some comfort from the consistency check that is part of the audit process, under which the auditor is required to assess the consistency of narrative and other reporting that accompanies the financial statements with the insights it has gained from the audit process. It would therefore be valuable to investors to have reporting under the Standards subject to this consistency check; this argues for such reporting to form part of the Annual Report, or at least the formally required annual reporting package that accompanies the financial statements.

Brian Kilpatrick	
……………………………………….	…………………………………………
Lisa Young–Harry	Brian Kilpatrick
Chief Executive Officer	Chief Investment Officer
HSBC Bank Pension Trust (UK) Limited	HSBC Bank Pension Trust (UK) Limited