ISSB meeting

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Project	**Exposure Draft S2 *Climate-related Disclosures***
Topic	**Climate resilience**
Contacts	**Claire Goydan** (claire.goydan@ifrs.org) **Jing Zhang** (jing.zhang@ifrs.org) **Rommie Johnson** (rommie.johnson@ifrs.org)

Objective

1. This paper continues the International Sustainability Standards Board's (ISSB's) redeliberations of the proposed requirements in paragraph 15 of [draft] IFRS S2 *Climate-related Disclosures* ([draft] S2) for entities to disclose their resilience to climate-related changes, developments or uncertainties. The proposed requirements are reproduced in Appendix A to this paper.

2. In this paper, the staff recommends the ISSB confirm the proposals in the Exposure Draft, and in response to stakeholder feedback:

   (a) take a number of related steps, including making amendments and developing guidance, to address feedback from respondents regarding climate-related scenario analysis and alternative methods for assessing climate resilience, including implications for how preparers should apply the Standard;

   (b) make several targeted drafting amendments intended to clarify important aspects of the requirements and further enable effective and consistent application; and

   (c) consider proposed guidance to help preparers select relevant scenarios when applying the standard.

3. The staff's specific recommendations are summarised in paragraphs 8–10 and discussed further in paragraphs 24–57.

4. The staff will ask the ISSB to vote on the recommendations in paragraphs 2(a) and 2(b) during this session.

Background

5. The ISSB published [draft] S2 in March 2022 and the comment period for the Exposure Draft ended in July 2022. The ISSB began its redeliberations in September 2022, considering feedback received during the comment period alongside emerging opportunities to more effectively meet the information needs of capital markets by enabling interoperability between IFRS Sustainability Disclosure Standards and jurisdictional sustainability standards.

6. In its October meeting, the ISSB discussed several staff recommendations associated with the requirements in paragraph 15 of [draft] S2. Specifically, the ISSB tentatively decided:

(a) to confirm the disclosures proposed in paragraph 15(a) of [draft] S2—that is, that an entity is required to disclose the results of its analysis of climate resilience and the particular information set out in that paragraph;

(b) to confirm the disclosures in paragraph 15(b) of [draft] S2 that describe how the climate resilience analysis has been conducted;

(c) to confirm the disclosure requirement proposed in paragraph 15(b)(i)(4) of [draft] S2—in other words, that an entity disclose whether it has used, among its scenarios, a scenario consistent with the latest international agreement on climate change. The ISSB thus confirmed:

   (i) that IFRS S2 will refer to the latest international agreement on climate change (ie the Paris Agreement will not be 'hard coded' into the requirements); and

   (ii) that entities are not required to use a specific scenario related to the latest international agreement on climate change or a 1.5C° scenario.

(d) to add a requirement to disclose whether and how an entity uses climate-related scenario analysis to inform the identification of climate-related risks and opportunities.

7. Building on the ISSB's prior tentative decisions, the staff has prepared additional recommendations to address feedback received during the comment period, which is summarised in paragraphs 14–23.

Summary of staff recommendations

8. The staff recommends that the ISSB address the feedback from respondents related to climate-related scenario analysis and alternative methods by taking the following steps to amend and enhance the proposals in [draft] S2:

   (a) require an entity to use climate-related scenario analysis to conduct its climate resilience assessment using a method that is commensurate with its size, capabilities and level of exposure to climate-related risk, and accordingly, remove references to 'alternative methods'; and;

   (b) develop application guidance, drawing on and referring to the TCFD guidance on climate-related scenario analysis, to assist entities in applying the requirement.

9. The staff also recommends that the ISSB clarify key aspects of the requirements proposed in [draft] S2 by making the following targeted drafting amendments:

   (a) amend the definition of 'climate resilience' in Appendix A to clarify that an entity's climate resilience includes both its strategic resilience and its operational resilience to uncertainties associated with climate change;

   (b) clarify that, although entities are likely to perform climate-related scenario analysis as part of a multi-year strategic planning cycle, the information in paragraph 15 of [draft] S2 is required to be disclosed annually; and

   (c) amend the terminology used in paragraph 15 of [draft S2] to clarify that scenario analysis is a tool with multiple possible applications and the assessment of climate resilience is one of those applications.

10. Finally, the staff recommends that the ISSB consider developing additional guidance to support preparers in selecting scenarios, including by providing guidance to consider the publicly available, off-the-shelf scenarios that are most relevant to their circumstances and most likely to support investor-focused disclosure.

Structure of the paper

11. This paper is structured as follows:

    (a) overview of the proposed requirements in [draft] S2 (paragraphs 12–13);

    (b) summary of feedback received (paragraphs 14–23);

    (c) staff analysis and recommendations (paragraphs 24–57); and

    (d) appendices

        (i) Appendix A—extract of the proposed climate resilience requirements in [draft] S2

        (ii) Appendix B—summary of relevant comments from AP4A *Climate-related Disclosures—Summary of comments* (September 2022)

        (iii) Appendix C—summary of similar approach used to classify financial assets in IFRS 9

        (iv) Appendix D—summary of the relevant requirements in the Exposure Draft of European Sustainability Reporting Standards (ESRS) and the U.S. Securities and Exchange Commission (SEC)'s proposed rule

Overview of the proposed requirements in [draft] S2

12. In paragraph 15(a)(i)-(v), [draft] S2 proposes that an entity disclose information that enables users of general purpose financial reporting to understand the resilience of the entity's strategy (including its business model) to climate-related changes, developments or uncertainties—taking into consideration an entity's identified significant climate-related risks and opportunities and related uncertainties. This includes requirements to disclose information about:

    (a) the results of the climate resilience assessment, which shall enable users to understand strategic implications, areas of uncertainty and adaptive capacity; and

    (b) the method used to conduct the climate resilience assessment, including whether the entity used climate-related scenario analysis or, if unable to do so, an alternative method.

13. The requirements are reproduced in full in Appendix A to this paper.

Summary of feedback received

14. With the publication of [draft] S2, the ISSB invited stakeholders to comment on the Exposure Draft, including on questions associated with the proposed requirements to disclose information on climate resilience. The staff also performed targeted outreach, which included discussions with preparers, investors, industry bodies, research organisations, regulators and subject matter experts. Most respondents broadly agreed with the information proposed to be disclosed related to climate resilience.

15. A summary of this feedback was presented in Agenda Paper 4A *Climate-related Disclosures—Summary of comments* (September 2022), and is reproduced in Appendix B to this paper. The staff has highlighted key aspects of this feedback in paragraphs 16–23.

Scenario analysis vs. alternative methods

16. Feedback was mixed on the proposed requirement to use scenario analysis unless unable to do so, in which case an entity would use an alternative method. Specifically, comments indicated differing interpretations of 'scenario analysis'.

17. Some respondents commented that requiring climate-related scenario analysis would create an undue reporting burden for smaller, less experienced or less well-resourced entities due to costs and complexity. A few respondents also stated that due to the developing nature of the practice, the variety of available models and limited data availability, requiring climate-related scenario analysis may not result in comparable disclosures. Many of these responses suggested an interpretation of climate-related scenario analysis that necessarily would require quantitative inputs, models and outputs.

18. Some other respondents commented that requiring climate-related scenario analysis is feasible and useful for a majority of entities. Specifically, many of these responses suggested an interpretation of climate-related scenario analysis that would include qualitative and narrative-based inputs, analysis and outputs.

19. Responses were mixed on the effectiveness of the 'unable to do so' mechanism. Some respondents noted that the mechanism may tacitly require or push entities to perform climate-related scenario analysis before they are ready or able. A larger portion of respondents said the 'unable to do so' mechanism may have the opposite effect, ie, that it may allow entities to opt out of performing climate-related scenario analysis.

20. Many respondents said that the Standard should require entities that are 'unable to do so' to describe their plan for building their capability to conduct climate-related scenario analysis, or to define a target timeframe for doing so.

21. Many respondents welcomed the use of alternative methods or techniques to assess climate resilience overall. Some respondents argued that allowing a range of alternative approaches may impair the comparability and usefulness of disclosure. Many respondents requested clarity and guidance on permitted alternatives.

Definition of 'climate resilience'

22. A few respondents said the definition of climate resilience proposed in Appendix A of [draft] S2 should be clarified. Specifically, these respondents noted the need for the definition to more explicitly encompass the resilience of an entity's operations in addition to its strategy and business model. These respondents stated that such clarifications would bring the definition of climate resilience into closer alignment with those of other relevant bodies, including the European Financial Reporting Advisory Group (EFRAG) and the Intergovernmental Panel on Climate Change (IPCC).

Selecting scenarios

23. In addition to information on the assumptions required in paragraph 15(b) of [draft] S2, some respondents requested additional guidance and clarity on the specific scenarios entities ought to consider in their climate resilience assessments, including potentially setting forth a standardised set of scenarios. Some respondents advocated for a full spectrum of scenarios in order to capture the full range of risks and potential costs to entities, as well as opportunities and potential investments from entities. To this end, these respondents recommended 'bookend' scenarios (e.g. 1.5 degrees Celsius and 4 degrees Celsius scenarios), as well as orderliness of transition, as elements to be included in an entity's climate-related scenario analysis.

Staff analysis and recommendations

24. During the period of analysing the feedback and forming its recommendations, the staff has extensively reviewed third-party guidance materials on climate-related scenario analysis, including those of the TCFD. The staff also did a literature scan of potential alternative methods to scenario analysis that entities might use to assess their climate resilience.

25. To understand the current state of climate resilience disclosure practice, the staff studied the TCFD 2021 and 2022 status reports and material from prudential climate stress testing programs such as the Bank of England's Climate Biennial Exploratory Scenario stress testing and the guidance materials produced by the Network of Central Banks and Supervisors for Greening the Financial System (NGFS). These materials gave staff further insights into the challenges and costs of conducting climate-related scenario analysis. The staff also examined some disclosure examples considered best practice by the TCFD secretariat or investors. Additionally, the staff engaged in several targeted discussions with investors to understand the elements of climate resilience disclosure in paragraph 15 of [draft] S2 that are most decision-useful to them.

26. To explore if any relevant insights could be drawn from financial accounting requirements where scenario analysis plays a role, the staff studied the implementation and application experience of the expected credit loss requirement in accordance with IFRS 9 *Financial instruments* and consulted several experts on this subject.

Staff recommendations for decision-making

27. Based on its analysis, the staff recommends the ISSB:

    (a) take a number of related steps, including making amendments and developing application guidance, to address feedback from respondents regarding:

        (i) what climate-related scenario analysis encompasses;

        (ii) the distinction made in [draft] S2 between climate-related scenario analysis and alternative methods for assessing climate resilience; and

        (iii) implications for how preparers should apply the Standard; and

    (b) several targeted drafting amendments intended to clarify important aspects of the requirements and further enable effective and consistent application.

Use of scenario analysis

28. Scenario analysis has become increasingly well established as a tool to help preparers and investors understand the potential effects of climate change on business models, strategies, financial performance and financial position.

29. Investors seek to understand whether and how entities use climate-related scenario analysis to inform risk identification and strategy formulation, as well as what the outcomes of the analysis indicate about the resilience of the entity's strategy, business model and future cash flows to a range of future climate scenarios (including whether the entity has considered a scenario consistent with the latest international agreement on climate change).

30. Paragraph 15 of [draft] S2 proposes that entities disclose information about their climate resilience, and would require them to use scenario analysis to make their assessments unless they are unable to do so. When an entity is unable to do so, [draft] S2 would require the entity to use an alternative method.

31. The requirement to use scenario analysis, and the associated relief (use of an alternative method if unable to use scenario analysis), was developed in an effort to balance two considerations:

    (a) clear signals from investors, creditors and other lenders that scenario analysis is the tool they prefer entities to use in assessing climate resilience and providing related disclosure, even if doing so requires an entity to build its capabilities over time; and

    (b) the perception among many preparers and other market participants that scenario analysis is an inherently complex and sophisticated exercise involving high costs and advanced quantitative capabilities, which creates an undue burden on smaller, less experienced entities or those less exposed to climate-related risk.

32. Feedback received during the comment period suggests that the approach taken in [draft] S2 was ineffective in resolving the tension between the two considerations outlined in paragraph 31, resulting in questions from many respondents about what constitutes scenario analysis, what doesn't constitute scenario analysis and, for preparers, which method they should use. The feedback suggests that the structure of the proposal, which makes a distinction between climate-related scenario analysis and alternative methods, may have in fact added confusion, in particular by implying that scenario analysis is necessarily quantitative.

33. For this reason, the staff recommends the ISSB take a number of related steps to simplify the structure of paragraph 15 of [draft] S2, to clarify the range of practice that is encompassed by the term 'scenario analysis', and to maintain necessary relief for entities while also maintaining an approach that helps ensure disclosure provides users of general purpose financial reporting with the information they need.

34. Specifically, staff recommends that the ISSB:

    (a) require an entity to use climate-related scenario analysis to conduct its climate resilience assessment, using an approach that is commensurate with its size, capabilities and level of exposure to climate-related risk; and

    (b) accordingly, remove references to 'alternative methods' in the climate resilience requirements.

35. The recommendations in paragraph 34 would clarify the requirement, reducing ambiguity caused by the distinction between climate-related scenario analysis and alternative methods, and thus provide more certainty to preparers regarding which method they should use.

36. Further, the explicit acknowledgement that scenario analysis is a tool that may be applied by an entity using a range of different approaches (ie, 'commensurate with [the entity's] size, capabilities and exposure') would:

    (a) for preparers, clarify that climate-related scenario analysis does not imply and would not require a one-size-fits-all approach to be used by all entities, regardless of their particular circumstances; and

    (b) for users of the information, enable reporting entities to provide them with decision-useful information as those entities build their analytical capabilities over time.

37. By requiring a particular approach (ie, scenario analysis) while also acknowledging that the approach can be sufficiently tailored to an entity's particular circumstances, the staff believes its recommended approach would reduce confusion among preparers and enhance the consistency of the Standard's application without significantly changing what would ultimately be required of preparers—and what is sought by investors—in terms of both analysis and disclosure.

Application guidance

38. Although the staff recommends that the ISSB require entities to use scenario analysis to prepare disclosures regarding their climate resilience, we also believe it would be essential to provide further guidance to assist entities in applying the requirement. Such guidance would need to acknowledge that scenario analysis encompasses a range of practice, while also helping preparers determine the approach that is best suited to their circumstances and thus what is required of them.

39. Specifically, the staff recommends application guidance that would assist preparers in applying the recommended requirement for an entity to use an approach to scenario analysis that is commensurate with its size, capabilities and exposure to climate-related risk.

40. Such guidance could, for example, reference the three broadly defined stages of progression described in the TCFD's *Technical Supplement: The Use of Scenario Analysis in Disclosure of Climate-Related Risks and Opportunities* (June 2017) and *Guidance on Scenario Analysis for Non-Financial Companies* (October 2020). Descriptions of those three stages, derived from the TCFD guidance, are included in Figure 1.

Figure 1. Stages of progression in the use of climate-related scenario analysis

Just beginning	**Gaining experience**	**Advanced experience**
Qualitative scenario narratives to help management explore the potential range of climate-related implications, using a more focused boundary such as a critical business unit or specific commodity inputs	Scenarios and associated analysis using quantitative information to illustrate potential pathways and outcomes, ideally for the entity and its operations as a whole	Greater rigour and sophistication in the use of data sets and mathematical models to support statistical analysis and quantitative, entity-specific outputs

41. The staff observes that the TCFD guidance thus sets out a concept of scenario analysis that encompasses a broader range of practice than many respondents may have assumed in reviewing and providing feedback on [draft] S2. For example, many of the respondents who disagreed with the proposed requirement to use scenario analysis cited its quantitative nature as overly burdensome to preparers. As implied by the three stages of progression described in Figure 1, scenario analysis involves:

(a) inputs (for example, scenarios and data sets);

(b) processes (for example, mathematical models and statistical analysis); and

(c) outputs (for example, implications for the entity or its value chain).

42. The staff notes that each of the elements listed in paragraph 41 may be either quantitative or qualitative in nature, as suggested by the TCFD guidance. The staff also notes that paragraph 15 of [draft] S2 further requires the entity to disclose information about how the entity interprets the outputs of the scenario analysis (for example, regarding the entity's adaptive capacity to respond under different scenarios). This additional information may also be either quantitative or qualitative in nature.

43. However, acknowledging this range of approaches without further specificity could create ambiguity for preparers considering how to apply the Standard. Thus, to clarify how an entity is required to apply the Standard, using an approach to scenario analysis that involves appropriate rigour, the application guidance could refer to the three stages of progression described in Figure 1 as a cascading series of application approaches. For example, an entity could be required to use the approach described as 'advanced experience' unless it is unable to do so, in which case it would be required to use the

approach described as 'gaining experience', and so on. If an entity is unable to use a given approach, the entity could be required to explain why it is unable to do so. Given the range of approaches included in Figure 1, at a minimum an entity would use the approach described as 'Just Beginning' in applying the requirement to use scenario analysis. (Further discussion of the 'unable to do so' mechanism is included in Agenda Paper 3C and 4C: *Scalability* from September 2022.) This approach of setting out the overarching requirement to use an approach that is commensurate with the entity's size, capabilities and level of exposure to climate-related risk supported by application guidance explaining how to apply this requirement is similar in structure to the approach used for the classification of financial assets in IFRS 9 *Financial Instruments*, as described in Appendix C.

44. The approach an entity would apply in meeting the requirement would thus reflect the stage of progression that is most appropriate to its circumstances, considering its resourcing, experience and degree of climate-related risk exposure. Disclosure would meanwhile provide users of the information with an understanding of the resilience of the entity's business model, implications for its strategy and its capacity to adapt, as well as with the transparency necessary to engage meaningfully with the entity about the approach it has taken to scenario analysis.

45. The staff believes, based on respondent feedback and its engagements with market participants, that investors find more rigorous, quantitative climate-related scenario analysis useful when it is not rushed, but rather has been developed over time by building on a solid framework of qualitative understanding. However, it is noted that putting entities on a path to the application of more sophisticated approaches is likely to encourage improvements in application and more robust information being provided over time. In the staff's view, the recommended amendments in tandem with the accompanying application guidance would both allow for and enable such a progression, facilitating disclosure that is consistent with the objective of [draft] S2, as entities' experience and market practice develops.

Targeted drafting amendments

46. Based on its analysis, described below, the staff further recommends several targeted drafting amendments intended to clarify important aspects of the requirements and support consistent application. Specifically, the staff recommends that the ISSB:

(a) amend the definition of 'climate resilience' in Appendix A to clarify that an entity's climate resilience includes both its strategic resilience and its operational resilience to uncertainties associated with climate change (paragraph 47);

(b) clarify that, although entities are likely to perform climate-related scenario analysis as part of a multi-year strategic planning cycle, the information required by paragraph 15 of [draft] S2 shall be disclosed annually (paragraph 48); and

(c) amend the terminology used in paragraph 15 of [draft] S2 to distinguish between scenario analysis as a tool with multiple applications and climate resilience assessment as one of those applications (paragraph 49).

47. Some respondents to the Exposure Draft said the definition of climate resilience included in [draft] S2 should more explicitly encompass the resilience of an entity's operations in addition to its strategy and business model. In the staff's view, such an amendment would be in keeping with the intent of [draft] S2, and could help enable more consistent application of certain requirements in the Standard, most notably those included in paragraph 15 of [draft] S2.

48. Another concern raised by respondents was that [draft] S2 implies an entity should conduct scenario analysis and disclose information about the analysis on an annual basis. Although scenarios are dynamic and scenario analysis is not a one-time process, entities typically refresh their scenarios and conduct their scenario analysis as part of their strategic planning cycle at varying frequencies often determined by the characteristics of the market or markets in which they operate. The staff recommends that the ISSB clarify that disclosure is required at each reporting date, even when the

underlying scenario analysis has been conducted in a prior reporting period. The staff further notes that the recommended approach implies that some disclosures regarding climate resilience will change less frequently, while others are likely to warrant updating for the current period. For example, information describing how an entity's scenario analysis has been conducted, as required in paragraph 15(b) of [draft] S2, may remain unchanged from one reporting period to the next, while information describing the implications for an entity's strategy, its significant areas of uncertainty and its capacities to adapt, as required in paragraph 15(a) of [draft] S2, may be updated in each period.

49. Finally, the staff recommends a third targeted drafting amendment to address confusion apparent in comment letters and in the staff's engagement with stakeholders. Paragraph 15 in [draft] S2 makes inconsistent use of the terms 'analysis' and 'assessment', both with and without modifiers, which may have implied that 'scenario analysis' and 'climate resilience assessment' are two terms that describe the same exercise. The staff notes that scenario analysis is a well-established tool for understanding uncertainty with a range of different applications, including identifying risks, developing strategy and assessing resilience. The staff recommends the ISSB make minor amendments to the requirements in paragraph 15 of [draft] S2 to consistently use the term 'assessment' when referring to the objective of the exercise and 'analysis' when referring to the tool used to conduct the exercise. Such an amendment could also help minimise confusion if references to scenario analysis are made in the context of other applications, such as its role in risk identification, which the ISSB voted to address via a new requirement at its October 2022 meeting (as covered in Agenda Paper 3C and 4D: *Interoperability—key matters*).

Areas for further consideration by the ISSB

50. In addition to the amendments and guidance discussed in paragraphs 24–49, the staff further proposes that the ISSB consider developing additional guidance and/or referring to appropriate third-party guidance to support preparers in selecting relevant scenarios when applying the Standard. Such guidance is likely to be important, as entities may conduct scenario analysis and select scenarios for a variety of purposes, including strategic planning, risk identification and estimating potential impacts. Some scenarios are likely to be more relevant than others for assessing climate resilience and supporting decision-useful disclosure for users of general purpose financial reporting.

51. The TCFD's most recent Status Report, published in October 2022, notes that preparers have identified 'conducting climate-related scenario analysis, including selecting relevant scenarios and identifying key inputs and parameters' as a primary challenge in making their disclosures. Meanwhile, users of the information suggested in the same report that 'us[ing] a standard scenario to assess the resilience of their strategies to climate change' would be among the most helpful improvements entities could make to increase the usefulness of their disclosures. The staff thus recommends the ISSB consider providing or directing preparers to guidance in this area.

52. Such guidance could, for example, build on the requirement in paragraph 15(b)(i)(4) of [draft] S2, which requires an entity to disclose whether it has used, among its scenarios, 'a scenario aligned with the latest international agreement on climate change'. In applying this requirement, entities may wish to consider publicly available, off-the-shelf scenarios to identify those most relevant to their circumstances and most likely to support investor-focused disclosure. These scenarios may include the range of scientifically-based, widely-accepted international and regional scenarios developed by the International Energy Agency (IEA), the IPCC, NGFS and others.

53. For example, entities that operate in the nearly 200 jurisdictions that have declared their commitments to contribute to the achievement of the Paris Agreement are likely to face increasing pressures to mitigate their greenhouse gas emissions and adapt to a lower-carbon economy. Such entities may benefit from conducting their analysis using a scenario consistent with a temperature increase of no more than 1.5°C or 2.0°C above pre-industrial levels, and/or a scenario consistent with the relevant jurisdictional commitments that could reasonably be expected to affect the entity or its operations.

54. Alternatively, where an entity, its operations and those entities and operations in its value chain are not significantly exposed to jurisdictional commitments, the entity may gain greater insight into its

climate resilience using a scenario consistent with the most recent global stocktake of the implementation of the Paris Agreement as a proxy for international exposure to climate-related transition and physical risk.

55. Finally, where an entity has a highly domestic value chain concentrated in a single country with no jurisdictional commitment in place, a regional scenario is most likely to inform a useful assessment of climate resilience and support investor-focused disclosure.

56. The staff believes guidance in this area would assist preparers in identifying and selecting scenarios that exhibit the key characteristics identified by the TCFD—plausible, distinctive, consistent, relevant and challenging—thus enhancing the quality of the analysis and the associated disclosure. Furthermore, by supporting preparers in selecting from commonly used reference scenarios, such guidance may also assist in addressing respondents' concerns about disclosure lacking comparability between entities.

57. The guidance could take a number of forms, including:

(a) application guidance, published as an integral part of the Standard and thus required to be used by preparers;

(b) implementation guidance, issued alongside the Standard, which would be essentially illustrative in nature and thus available for voluntary use by preparers;

(c) illustrative examples, issued alongside the Standard, which would be available for voluntary use by preparers and highlight how the requirements might be applied in a specific circumstance or set of circumstances; and

(d) reference to third-party guidance, such as the TCFD guidance, which would enable the ISSB to refer to and align practice with the tools and resources already familiar to and in wide use by preparers, but could change or become superseded outside the control of the ISSB.

Questions for the ISSB

1. Does the ISSB agree with the staff's recommendation (in paragraph 34) that entities be required to use climate-related scenario analysis to conduct their climate resilience assessment using a method that is commensurate with their particular circumstances (and, accordingly, remove references to 'alternative methods')?

2. Does the ISSB agree with the staff's recommendation (in paragraph 39) to develop application guidance that would draw on related TCFD guidance to assist preparers in applying the requirement outlined above with appropriate rigour?

3. Does the ISSB agree with the recommended drafting amendments (in paragraphs 46–49 to clarify:

   (a) the definition of climate resilience;

   (b) the requirement for annual disclosure even when the scenario analysis is not conducted annually, and

   (c) the use of the terms 'analysis' and 'assessment'?

4. Does the ISSB agree that the staff should explore developing or referring to guidance on selecting relevant scenarios (as described in paragraphs 50–57?

Appendix A—extract of the proposed climate resilience requirements in [draft] S2

A1. Proposal covered in this paper: paragraph 15 of [draft] S2

15. An entity shall disclose information that enables users of general purpose financial reporting to understand the resilience of the entity's strategy (including its business model) to climate-related changes, developments or uncertainties—taking into consideration an entity's identified significant climate-related risks and opportunities and related uncertainties. The entity shall use climate-related scenario analysis to assess its climate resilience unless it is unable to do so. If an entity is unable to use climate-related scenario analysis, it shall use an alternative method or technique to assess its climate resilience. When providing quantitative information, an entity can disclose single amounts or a range. Specifically, the entity shall disclose: An entity shall disclose information relevant to these cross-industry metric categories:

(a) the results of the analysis of climate resilience, which shall enable users to understand:

(i) the implications, if any, of the entity's findings for its strategy, including how it would need to respond to the effects identified in paragraph 15(b)(i)(8) or 15(b)(ii)(6);

(ii) the significant areas of uncertainty considered in the analysis of climate resilience;

(iii) the entity's capacity to adjust or adapt its strategy and business model over the short, medium and long term to climate developments in terms of:

1. the availability of, and flexibility in, existing financial resources, including capital, to address climate-related risks, and/or to be redirected to take advantage of climate-related opportunities;
2. the ability to redeploy, repurpose, upgrade or decommission existing assets; and
3. the effect of current or planned investments in climate- related mitigation, adaptation or opportunities for climate resilience.

(b) how the analysis has been conducted, including:

(i) when climate-related scenario analysis is used:

1. which scenarios were used for the assessment and the sources of the scenarios used;
2. whether the analysis has been conducted by comparing a diverse range of climate-related scenarios;
3. whether the scenarios used are associated with transition risks or increased physical risks;
4. whether the entity has used, among its scenarios, a scenario aligned with the latest international agreement on climate change;
5. an explanation of why the entity has decided that its chosen scenarios are relevant to assessing its resilience to climate-related risks and opportunities;
6. the time horizons used in the analysis;
7. the inputs used in the analysis, including—but not limited to—the scope of risks (for example, the scope of physical risks included in the scenario analysis), the scope of operations

covered (for example, the operating locations used), and details of the assumptions (for example, geospatial coordinates specific to entity locations or national- or regional-level broad assumptions); and

8. assumptions about the way the transition to a lower- carbon economy will affect the entity, including policy assumptions for the jurisdictions in which the entity operates; assumptions about macroeconomic trends; energy usage and mix; and technology.

(ii) when climate-related scenario analysis is not used:

1. an explanation of the methods or techniques used to assess the entity's climate resilience (for example, single-point forecasts, sensitivity analysis or qualitative analysis);
2. the climate-related assumptions used in the analysis including whether it includes a range of hypothetical outcomes;
3. an explanation of why the entity has decided that the chosen climate-related assumptions are relevant to assessing its resilience to climate-related risks and opportunities;
4. the time horizons used in the analysis;
5. the inputs used in the analysis, including—but not limited to—the scope of risks (for example, the scope of physical risks included in the analysis), the scope of operations covered (for example, the operating locations used), and details of the assumptions (for example, geospatial coordinates specific to entity locations or national- or regional-level broad assumptions);
6. assumptions about the way the transition to a lower- carbon economy will affect the entity, including policy assumptions for the jurisdictions in which the entity operates; assumptions about macroeconomic trends; energy usage and mix; and technology; and
7. an explanation of why the entity was unable to use climate-related scenario analysis to assess the climate resilience of its strategy.

Appendix B—summary of comments from AP4A Summary of Comments from September 2022

Question 7(a)—Results of the analysis of climate resilience

B1. Most respondents, in particular most users of general purpose financial reporting and standard-setters, agreed that the items listed in paragraph 15(a) in [draft] S2 reflect what users need to understand about the climate resilience of an entity's strategy. While most users agreed with the proposed items listed in paragraph 15 in [draft] S2:

a. some users noted the need for further capacity building, including guidance and illustrative examples.

b. a few users noted that some of the items may not be relevant for all sectors. They argued that the ISSB should consider developing additional sector-specific requirements, or sector-specific guidance.

B2. A few respondents argued that while they agreed with the items listed in paragraph 15(a) in [draft] S2, an entity should not be required to disclose information, practices or assumptions that are proprietary or commercially sensitive when disclosing the results of the analysis of its climate resilience.

B3. A few respondents noted the need for further clarity on definitions and terminology, including suggestions to amend:

a. the definition of climate resilience to better align it with the IPCC definition;

b. paragraph 15(a)(ii) in [draft] S2 to clarify the threshold for ‘significant’ areas of uncertainty;

c. paragraph 15(a)(iii) in [draft] S2 to clarify whether the entity’s definition of short, medium and long term should be consistent with what it disclosed in paragraph 9(b) in [draft] S2.

Question 7(b)—Using alternative methods or techniques if unable to use climate-related scenario analysis

B4. Many respondents welcomed the use of alternative methods or techniques to assess climate resilience when an entity is unable to conduct climate-related scenario analysis, in particular almost all regulators and accounting professionals and auditors agreed with this.

B5. Many users of general purpose financial reporting agreed with the proposed requirement that an entity use climate-related scenario analysis to assess its climate resilience unless it is unable to do so, in which case the entity is required to use an alternative method or technique to assess its climate resilience. Specifically, these users said that:

a. undertaking climate-related scenario analysis is a core TCFD recommendation and an essential tool to support users in understanding an entity’s exposures to transition and physical risks, and how the entity is managing these risks.

b. it enables users to assess the effects of climate-related risks and opportunities on an entity’s enterprise value.

c. undertaking climate-related scenario analysis can be challenging for entities, as they lack the resources and capabilities at present to undertake the climate-related scenario analysis. When an entity is unable to use climate-related scenario analysis, using an alternative method or technique to scenario analysis is preferred to no disclosure on an entity’s climate resilience.

B6. However, a few respondents, in particular some respondents from academia, public interest organisations and respondents representing industry groups, and some respondents from North America, disagreed with the proposed requirement. The reasons for disagreeing with the proposed requirement varied, specifically:

a. a few respondents, in particular respondents from academia, disagreed with allowing alternatives saying that alternative approaches to assess climate resilience may impede comparability and should only be allowed as a transitional tool;

b. a few respondents noted that further guidance is needed for the alternative methods and techniques;

c. a few respondents argued that scenario analysis should not be required until the methodologies necessary to conduct and disclose useful results of climate-related scenario analyses are sufficiently well developed; and

d. a few respondents, in particular respondents representing industry groups and from North America, disagreed that the use of climate-related scenario analysis should be required at all.

B7. Some respondents raised a need for further guidance on when an entity would be considered unable to use climate-related scenario analysis and/or under which circumstances this would be expected.

Question 7(c)—Proposed disclosures about an entity's climate-related scenario analysis

B8. Most respondents, including most respondents from academia, regulators and accounting professionals and auditors, broadly agreed with the disclosures about an entity's climate-related scenario analysis. These respondents said that this level of transparency will support users of general purpose financial reporting when evaluating how an entity has arrived at the results of the analysis.

B9. Many respondents noted that there is a significant burden on entities to use climate-related scenario analysis, in particular for entities with less experience in climate-related disclosures or for smaller entities, as these are likely to be more resource constraints. As such, many respondents noted that more time may be needed. Furthermore, the need for additional guidance was highlighted.

B10. Finally, some respondents argued that the disclosures should require inclusion of a 2-degree Celsius or 1.5-degree Celsius scenario, as they argued this is necessary for enabling users of general purpose financial reporting to assess the resilience of an entity's business model to transition risks.

Question 7(d)—Proposed disclosure about alternative techniques used for the assessment of the climate resilience of an entity's strategy

B11. Most respondents, including almost all regulators, most preparers and many users of general purpose financial reporting, broadly agreed with the proposed disclosures about alternative techniques to enable the assessment by users of an entity's climate resilience. These respondents said that the disclosures would enable entities to disclose useful information to assess the entity's climate resilience when entities are unable to use climate-related scenario analysis. These respondents said that they view climate-related scenario analysis as the main tool for entities to use once they are able to.

B12. A few respondents raised a concern that the proposed disclosures for alternative techniques lack clarity and that further guidance was needed to assist preparers.

Question 7(e)—Cost-benefit of an entity's strategic resilience to climate change

B13. Most respondents, including most users of general purpose financial reporting and regulators and many preparers, agree that the proposed disclosure requirements appropriately balance the costs of applying the requirements with the benefits of information on an entity's strategic resilience to climate change.

B14. By jurisdiction, the feedback was mixed:

a. almost all respondents in Africa and most respondents in Europe and South and Latin America agreed with the cost-benefit balance of the proposed requirement;

b. only some respondents in Asia-Oceania expressly agreed with the cost-benefit balance of the proposed requirement; and

c. some respondents in North America expressed disagreement that the requirements appropriately balance the costs with the benefits of the information.

B15. A few respondents noted that the costs of performing scenario analysis are high across entities, but that the benefits outweigh the costs in the long run.

How staff quantified the feedback

B16. This paper uses the following terms to describe the extent to which feedback was provided by respondents, which is defined as stakeholders who submitted a comment letter or survey response:

Term	**Extent of response among respondents**
Almost All	All except a very small minority
Most	A large majority, with more than a few exceptions
Many	A small majority or large minority
Some	A small minority, but more than a few
A few	A very small minority

Appendix C—summary of similar approach used to classify financial assets in IFRS 9

C1. In paragraphs 34 and 39 of this paper, the staff recommends the ISSB:

(e) require an entity to use climate-related scenario analysis to conduct its climate resilience assessment using a method that is commensurate with its size, capabilities and level of exposure to climate-related risk, and accordingly, remove references to 'alternative methods'; and;

(f) develop application guidance, drawing on and referring to the TCFD guidance on climate-related scenario analysis, to assist entities in applying the requirement.

C2. The staff's recommended approach recognises that entities, particularly those new to climate-related scenario analysis, may be challenged to identify a method that is commensurate with their particular circumstances. It is conceptually modelled after the approach used for the classification of financial assets in IFRS 9 *Financial Instruments*.

C3. IFRS 9 requires an entity to classify assets into three principal measurement categories (amortised cost, fair value through other comprehensive income, and fair value through profit or loss) on the basis of the entity's business model for managing the asset and the contractual cash flow characteristics of the asset.

C4. For example, a financial asset is classified as being subsequently measured at amortised cost if the asset is held within a business model whose objective is to collect contractual cash flows, and the contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest (SPPI).

C5. Appendix B to IFRS 9 provides guidance on how to apply these conditions, including guidance on how a preparer would use judgement to assess its business model in consideration of all relevant evidence, not just a single factor.

C6. The staff envisions a similar appendix to IFRS S2, providing guidance to preparers on how to apply the requirement to use climate-related scenario analysis to conduct its climate resilience assessment using a method that is commensurate with its size, capabilities and level of exposure to climate-related risk.

C7. The general features of the staff's proposed approach to such guidance are set out in paragraphs 38–45 of this paper. However, the staff would need to develop more detailed guidance for entities to effectively apply the requirement and to consider the 'unable to do so' mechanism, which is intended to provide relief, such that an entity unable to use the required approach to preparing its disclosures would instead be required to use an alternative approach to preparing its disclosures. The staff's initial thinking is that, as with the two 'tests' in IFRS 9 (for business model and contractual cash flow characteristics), an entity may need to consider separately the significance (ie, the likelihood, magnitude and velocity) of its risk exposures and key aspects of its 'ability to do so', such as its size, access to resources, experience and expertise.

Appendix D—summary of the U.S. Securities and Exchange Commission (SEC) proposed rule and the requirements in the Exposure Drafts of the European Sustainability Reporting Standards (ESRS)

D1. In addition to the ISSB's proposed requirements, a number of jurisdictions are working to establish sustainability disclosure standards. In Europe, the European Financial Reporting Advisory Group (EFRAG) is working to finalise proposed European Sustainability Reporting Standards (ESRS). In the United States, the US Securities and Exchange Commission (US SEC) proposed rule changes that would require registrants to include particular climate-related disclosures in their registration statements and periodic reports. As a matter of the redeliberation of [draft] S1 and S2, the ISSB is working to optimise interoperability with these and other proposed standards to develop a global baseline of disclosure requirements. Both the U.S. SEC and EFRAG have addressed the matters of climate resilience and scenario analysis.

D2. The U.S. SEC's proposed rule changes would ask a reporting entity to 'describe the resilience of [its] business strategy in light of potential future changes in climate-related risks', although it does not provide an explicit definition of climate resilience in its proposal. The SEC proposal would ask a reporting entity to disclose information about its use of any analytical tools, such as scenario analysis, 'to assess the impact of climate-related risks on its business and consolidated financial statements, and to support the resilience of its strategy and business model'. The proposed requirement references climate-related risks but does not explicitly mention opportunities. Where an entity uses scenario analysis to assess the resilience of its strategy to climate-related risks, the proposal would require disclosure of the scenarios used, but does not mandate the use of any specific scenarios or set of scenarios. In such cases, the proposal would further require disclosure of 'parameters, assumptions, and analytical choices' and the 'projected financial impacts on the registrant's business strategy under each scenario'. The proposed rule states that 'the disclosure should include both qualitative and quantitative information.'

D3. The Exposure Draft of ESRS 2 ("General, strategy, governance and materiality assessment") proposes an entity be required to disclose the resilience of its strategy and business model with regard to sustainability risks and opportunities. The Exposure Draft of ESRS E1 ("Climate change") proposes guidance to assist preparers in applying the resilience assessment disclosure requirement in the context of climate change. The guidance would require an entity to disclose the scope of its assessment, how the assessment was conducted and the results of the assessment. Meanwhile, the Exposure Drafts of ESRS 2 and E1 further propose that an entity be required to disclose information about how it has used scenario analysis to inform its identification of sustainability risks and opportunities, including the scenarios used, the relevant time horizons and the critical assumptions and key inputs used. ESRS E1 requires an entity to disclose 'plans to ensure that its business model and strategy are compatible with the transition to a climate-neutral economy and with limiting global warming to 1.5 °C in line with the Paris Agreement'. The ESRS Exposure Drafts do not explicitly define 'climate resilience'.