Comments on the ISSB's S1 General Requirements for Sustainability-related Financial Information Exposure Draft

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We represent institutions with collectively many decades of experience working to improve the rights of workers globally. As part of a formal research collaboration between the Value Reporting Foundation and Rights CoLab since 2020, we have been advising SASB staff on how to better reflect human rights risks in the standards, particularly in relation to rights at work.

We applaud the IFRS Foundation for issuing the General Requirements for Sustainability-related Financial Information Exposure Draft. It is a critical milestone in the global drive for a sustainable future to acknowledge that, "This [draft] Standard requires an entity to disclose material information about all of the significant sustainability-related risks and opportunities to which it is exposed." This principle must form the foundation of any set of standards aimed at the goal of investor protection.

We recommend changes to the Exposure Draft that we feel would result in significant improvements to investor protection. These changes stem from fundamental differences between sustainability-related financial information and traditional financial information, which IFRS is accustomed to acting upon. As we do not expect the General Requirements to be significantly altered once adopted, the IFRS will have one chance to get this right while navigating a rapidly changing environment, and despite the urgency in having sustainability standards, it is essential that IFRS develop the most comprehensive approach practicable.

Our recommendations build off of three characteristics of sustainability reporting:

1. **Sustainability-related financial information is forward-looking:** It encompasses, but goes beyond, information that addresses past or current impacts to investors from changes to enterprise value. This essential feature distinguishes it from traditional general purpose financial reporting, and has implications for protection of diverse investors, who have different considerations of systemic risk and the opportunities that arise from systems change, and varying time horizons, which the ISSB will need to account for.

2. **Sustainability-related financial disclosures include externalities:** Sustainability-related financial disclosures differ qualitatively from general purpose financial reporting in that corporate accountability for sustainability goes beyond observable impacts to enterprise value; it also includes externalities. Reporters tend to be less careful in measuring their externalities and often are not even aware of them. This difference justifies the need for changes in the ISSB's proposed approach to assessing materiality.
3. **Sustainability reporting requires broader stakeholder engagement:** Rapidly evolving sustainability risks may not only exist outside of a company's field of vision; they can be actively concealed. The ISSB should adopt processes for standard-setting that ensure that those with first-hand knowledge of these risks can inform determinations of materiality. The ISSB can accomplish this goal by formalizing engagement with civil society organizations as an aspect of its due process.

Below we elaborate on these points with three recommendations.

1. **The ISSB should produce comprehensive guidance for disclosure of systemic risks[1] to the economy, which negatively impact portfolios owned or managed by well-diversified, long-term investors. The ISSB should also deem salient[2] systemic risks to be material by definition.**

Sustainability-related information implies new forms of investor protection. The concept of sustainability goes beyond the risks and opportunities that affect a single company, to encompass risks and opportunities that affect entire socio-economic and financial systems, which in turn could affect the value of every investor's portfolio. A lender's decision to offer a loan primarily revolves around the risks directly to the borrower. An asset owner seeking to make an investment in an index fund, however, not only cares about the way that sustainability factors affect individual index constituents, but is also interested in the performance of the index itself. Moreover, the largest questions within sustainable investing concern macro phenomena that affect the entire economy, such as climate change, economic inequality, and erosion of the rule of law and increasing authoritarianism. In such cases, the fiduciary will be rightly concerned, not with the effect of climate risk on a single corporation's enterprise value, but the effect of climate risk on the entire portfolio.

For these investors, corporate behavior that would normally be considered to be in the realm of double materiality actually receives primary importance in voting decisions and the like. The only way that any company can avoid a material adjustment to its enterprise value from a systemic risk is to do its part to ameliorate that risk, by eliminating its externalities, and advocating for policy changes from government and behavioral changes from stakeholders. Climate Action 100+ is one example of a coalition of some of the world's most significant investors who find it within their fiduciary duty to demand disclosure of externalities and plans

[1] Here we use "systemic risks" in the sense of risks to financial and economic systems from climate change, socio-economic inequality, etc. rather than risks stemming from the system (such as "systemic racism").
[2] Saliency is used in the sense of "most severe negative impacts."

to address them. These disclosures may also end up being financially material to individual companies, but the reasoning of Climate Action 100+ fiduciaries is to protect entire portfolios, not scattered constituents of portfolios.

Another relevant feature of sustainability-related financial information is that it is primarily forward-looking. This characteristic contrasts sharply with current general purpose financial reporting, for which forward-looking statements often must be accompanied by disclaiming language. As the Exposure Draft correctly recognizes, sustainability-related financial information may be significant over the short-, medium- or long-term. However, the time frames in which different kinds of sustainability-related financial information operate vary by orders of magnitude. Whereas the worst effects of climate change may not occur for 50-60 years, human rights violations and their financially material risks are happening now and forecasting human rights violations decades into the future makes little sense.

The relevant time frames of users of sustainability-related information are similarly heterogeneous. A lender who uses sustainability-related financial information to help decide whether to issue a two-year revolving credit facility to an oil company may have little interest in risks that might not manifest until 2060. In contrast, a pension fund trustee who has a duty of care to beneficiaries far into the future may be very focused on 2060 events.

Companies and investors accustomed to general purpose financial reporting are familiar with financial materiality and idiosyncratic risk to specific issuers over short time frames. But short and long-term systemic risk may be a foreign concept to them. Also, since systemic risks are generated by externalities, issuers may not be aware of them. For these reasons externalities that create systemic risk rarely, if ever, enter into a materiality assessment, and are therefore rarely, if ever, disclosed. That is one reason that the Task Force on Climate-related Financial Disclosures, one of the most well-accepted sustainability frameworks, declares that salient systemic risk must be disclosed independent of a materiality assessment.[3] By building on the TCFD framework, ISSB has already introduced GHG emissions as a driver of systemic risk that must be disclosed by all issuers.

We urge the ISSB, as it makes further progress on additional sustainability themes with specific regard to social standard setting, to require disclosure concerning other salient systemic risks, such as economic inequality. To not act in this way introduces arbitrary and unacceptable bias into the standards. Moreover, inclusion of systemic risk disclosures will help to harmonize the ISSB and EFRAG standards, showing that the difference between financial and double materiality "is more apparent than real," in the words of the current IOSCO Chair.[4]

[3] The Task Force on Climate-related Financial Disclosures recommends that all organizations "should provide their Scope 1 and Scope 2 GHG emissions independent of a materiality assessment, and, if appropriate, Scope 3 GHG emissions and the related risks. All organizations should consider disclosing Scope 3 GHG emissions." https://www.tcfdhub.org/metrics-and-targets/.

[4] https://www.esginvestor.net/impact-will-have-its-place-in-issb-reporting-iosco-chair/

2. The ISSB should clarify and elaborate on the guidance for how issuers determine materiality. In turn, it should make human rights and environmental due diligence the starting point of any materiality assessment.

Investor protection dictates that companies must not omit information on topics that investors consider material.[5] The definition of material sustainability-related information changes over time, and mainly concerns externalities – social and environmental impacts produced by company operations. Companies may or may not be assessing their externalities, and therefore may not be aware of them. For these reasons a sustainability-related materiality assessment must be grounded in consultation with investors. A key weakness of the Exposure Draft is that it doesn't account for this, but instead provides vague and inadequate guidance that allows managements to decide arbitrarily whether a disclosure topic is material or not.

The ISSB should provide guidance for best practice in a sustainability-related materiality assessment and require disclosure of every company's process for determining what is material. The Global Reporting Initiative details in exhaustive fashion how a reporting entity should consider the factors that enter into its materiality assessment.[6] In a similar fashion, the ISSB should require disclosure regarding engagement with each company's financial stakeholders so that investors can understand why and how the issuer determined which topics were material, over and above the required disclosure of contributions to systemic risk irrespective of a materiality assessment.

The ISSB can improve its guidance regarding the materiality process by including, at minimum, the following:

- **Clear definitions of short-, medium-, and long-term**: Without specifying what these time frames mean, their definition is left to management itself. This produces two serious problems. First, companies will not define time frames in the same way, which will undermine ISSB's objective of comparability. Second, many companies have a planning horizon that doesn't go beyond five years. If five years is considered long-term, then most of the risks of climate change, for example, will simply be deemed immaterial and omitted from reporting. The ISSB might consider adapting its conception of time frames to those utilized generally by net-zero frameworks: short-term would be defined as five years into the future, medium-term as another ten years, and long-term as fifteen years or more into the future.

- **The requirement that any materiality assessment include a description and result of each issuer's human rights and environmental due diligence assessment (HREDD):**

[5] "Of course it's true that materiality—the importance of a subject to a reasonable investor—is the touchtone of our securities laws. But too much of corporate America has forgotten who decides what is material….I want to remind everyone, and the corporate counsel with whom shareholder proponents engage with each year, that it is the investor who tells us what's important." Robert Jackson, "Investors Determine Materiality," Proxy Preview 2019 (https://www.proxypreview.org/all-contributor-articles/investors-determine-materiality).

[6] https://www.globalreporting.org/pdf.ashx?id=12453

HREDD is the best practice method for an issuer to determine its most salient externalities that contribute to idiosyncratic risks to its enterprise value, as well as systemic risks affecting investors' portfolios. The Climate Disclosure Standards Board's (CDSB) Framework for Reporting Environmental and Social Information, which is now incorporated into IFRS non-mandatory guidance, stresses that sustainability information is relevant when it "[c]omplies with mainstream corporate requirements or with compliance requirements on the conduct of human rights and environmental due diligence and/or on the disclosure of environmental and social information." The document cites the U.N. Guiding Principles as the recommended guide to due diligence, especially in relation to social information. The ISSB should mandate that reporters conduct regular and ongoing HREDD based on the U.N. Guiding Principles on Business and Human Rights and the OECD Guidelines for Multi-National Enterprises, referencing the full cycle of identifying, avoiding, mitigating, and remedying impacts.

3. To achieve its objectives, the ISSB should provide a formal role for civil society in its standard setting process.

Sustainability issues are rapidly evolving, and companies are acknowledging material sustainability risks that didn't exist even a few years ago. These rapid changes have spurred SASB/VRF to initiate or complete twelve standards updating projects within just three years of its initial publication. The rapid evolution of sustainability risks is further complicated by the fact that enterprises can actively conceal them from corporate oversight.

Civil society leaders, including front line human rights defenders, possess the knowledge of the root causes of future risks and therefore are indispensable to risk identification and exposure. They constitute the early warning system of sustainability-related information for both companies and investors. As noted above, as an Expert Group, we have engaged with SASB staff for the past three years on human capital issues.[7] We have advised the staff on the development of its Human Capital Framework, and its related standard-setting projects, including on Diversity, Equity and Inclusion and Raw Materials Sourcing in Apparel, Footwear, and Accessories. Staff feedback indicates that this input is highly valued. We urge the ISSB to expand its due process to formalize a prominent place for civil society representatives.

This issue is particularly significant in light of the ISSB Board's under-representation of individuals from the Global South, where the preponderance of negative harms of corporate operations occur. Of the ten ISSB members appointed so far, two are from Asia and one is from Africa. The rest are from North America and Europe/U.K. – rendering the board unrepresentative of the global population. An enhanced role for civil society can help to remedy this gap.

Thank you for this opportunity to comment on the Exposure Draft. We look forward to ongoing engagement with the ISSB.

[7] https://rightscolab.org/project-harnessing-big-data/

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