ISSB AND SEC PUT THE SQUEEZE ON CANADA'S CLIMATE REPORTING PLANS

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Author: Alyson Slater, *Senior Director, Sustainable Finance*
Alexandria Fisher, *Manager, Sustainable Finance*

GRI GLOBAL RISK INSTITUTE

After two decades of multiple voluntary sustainability reporting frameworks gaining footholds in the market, the move toward global, mandatory, standardized reporting has been lightning fast in comparison. We take a look at recent international developments and what this means for Canada.

The International Financial Reporting Standards (IFRS) Foundation formed a new body under its auspices, known as the International Sustainability Standards Board (ISSB), whose remit is to develop global standards for sustainability disclosures focused on meeting the information needs of investors. They leveraged uptake and momentum in the market, behind existing voluntary frameworks, by absorbing the Financial Stability Board's Task Force for Climate Related Financial Reporting (TCFD) and the Sustainability Accounting Standards Board (SASB) standards, both built in response to investor needs for better information about environmental, social and governance data from issuers. Only months after being formed, the ISSB issued the draft IFRS S2 Climate-Related Disclosure Standard (known as the ISSB exposure draft) for public comment.[1]

Concurrently, the U.S. Securities and Exchange Commission (SEC) issued a proposed rule called The Enhancement and Standardization of Climate-Related Financial Disclosures for Investors.[2] This would require issuers to include climate-related disclosures in their registration statements and periodic reports, including information about climate-related risks that are reasonably likely to have a material impact on their business, operations, or financial condition, and certain climate-related financial metrics in a note to their audited financial statements. The SEC's proposed framework also takes the TCFD and SASB voluntary standards as its baseline in terms of disclosure requirements for climate governance, strategy, risk management and targets, and is therefore very closely aligned with the ISSB exposure draft.

The substantial alignment between the SEC proposal and the ISSB exposure draft is a concrete step toward a global baseline of investor-focused climate disclosures which will promote capital market efficiency by avoiding duplications and can reduce the burden on issuers. In its public consultation, the SEC seeks input on whether to allow Foreign Private Issuers, or even all registrants, to use the ISSB standards to meet SEC climate reporting obligations consistent with SEC allowance for use of IFRS Accounting Standards. Paragraph 189 of the SEC release asks, "If we adopt an alternative reporting provision, should that provision be structured to encompass reports made pursuant to criteria developed by a global sustainability standards body, such as the ISSB? If so, should such alternative reporting be limited to foreign private issuers, or should we extend this option to all registrants?"

The multijurisdictional disclosure system (MJDS) permits eligible Canadian issuers to publicly offer securities in the United States by using a prospectus that is prepared principally in accordance with Canadian disclosure requirements, and satisfy their reporting obligations by using their Canadian continuous disclosure documents. Consistent with the above mentioned inquiry on

1 The International Financial Reporting Standards (IFRS) Foundation's ISSB consultation closes July 29, 2022.

2 The U.S. SEC proposed rule consultation is open until June 17, 2022.

alternative reporting provisions, Paragraph 181 clarifies that the SEC has not proposed to amend Form 40-F and require Canadian MJDS issuers to comply with the climate disclosure rule, and asks, "Should we permit a MJDS issuer to comply with Canadian climate-related disclosure requirements instead of the proposed rules if they meet certain conditions or provide certain additional disclosures and, if so, which conditions or disclosures?" It would reduce duplicative reporting if the SEC would allow MJDS issuers to follow Canadian requirements, and this seems likely if the Canadian Securities Administrators (CSA) would ultimately adopt and align with the emerging ISSB standard, but this is not yet an assured path forward.

The CSA issued Proposed National Instrument 51-107 Disclosure of Climate-related Matters for consultation in late 2021. When initially released, the CSA's proposal was aligned with the TCFD's voluntary guidance, but left out key significant elements (Table 1). The Proposed National Instrument has now become increasingly out of step as the ISSB and SEC released their significantly more granular and ambitious draft climate-related disclosure requirements for publicly-traded companies. This will only be compounded for Canada as the global umbrella group of securities regulators, the International Organization of Securities Commissions (IOSCO), is currently reviewing ISSB's proposal with an intent to endorse the final standards. Once supported by IOSCO, local regulators worldwide would be expected to incorporate the standards.

Table 1: Key gaps between the CSA Proposed National Instrument and the ISSB and SEC exposure drafts

Areas of misalignment	Why this is important
Scenario Analysis: ISSB and SEC expect issuers to report on their use of climate scenario analysis or similar techniques to test their resilience to physical and transition risks while the CSA instrument would not.	Climate risk scenario analysis is a key tool in helping firms of all sizes understand what the future may hold in terms of physical and transition risk, can inform materiality assessment and business strategy, and should therefore be a reporting requirement for Canadian public companies.
Scope 3 Emissions: The ISSB draft proposal and the SEC rule would require Scope 3 greenhouse gas (GHG) emissions reporting, if deemed material or part of a corporate net-zero emissions commitment. The CSA proposed to mandate Scope 1 and Scope 2 emissions on a "comply or explain" basis, and Scope 3 emissions disclosure would be voluntary. An alternative suggestion from the CSA only requires reporting Scope 1 emissions.	The process of assessing and disclosing Scope 3 emissions will help all issuers better understand the size and nature of their carbon exposure and is the foundational building block of any low-carbon transition plan. Scope 3 emissions are often a more significant source of emissions for issuers than Scope 1 and 2 combined and the greatest source of transition risk.
GHG Protocol: The protocol is the long-accepted global standard for GHG emissions calculations and underpins the emissions reporting indicators of the widely-used global voluntary reporting standards (including TCFD and SASB) and is integrated into the climate risk reporting prototypes issued by the ISSB and the SEC. The CSA Instrument would not mandate the use of the GHG Protocol.	Uptake of the GHG Protocol by Canadian firms is widespread, as it is among the world's largest and publicly-traded firms. In support of the CSA's intention to improve comparability and consistency, and reduce cost and fragmentation, reporting in alignment with the GHG Protocol should be a basic building block.

Based on submissions by investors and other key stakeholders in response to the CSA's Proposed National Instrument, several messages came to the fore:

- Investors want reliable, relevant, and comparable information on climate-related risks from all issuers.
- The market needs mandatory disclosure standards aligned with international regulations.

Investors and financial institutions require information about material climate-related impacts and risks among counterparties and issuers in order to inform risk assessment and decision making. Aligning with global norms is a step toward increased standardization and comparability, establishing a common framework, and eliminating greenwashing. These disclosure requirements should be viewed as an opportunity to improve Canadian competitiveness in the face of increased disruption from physical climate risks, and the shocks that a transition to a low-carbon economy are sure to bring. Financial analysts will estimate or model data for issuers that do not disclose, and will include a buffer for, uncertainty which is not to the issuer's benefit. In an era of heightened greenwash risk, actions perceived by investors as red flags include company reporting in non-standardized formats and not reporting on all material issues.

A weaker or misaligned reporting standard will ultimately disadvantage Canadian companies, especially those cross-listed in other markets with more stringent disclosure standards – and against global peers. Canadian firms must stay ahead of climate risk to remain competitive in the changing policy and investor landscape. This is important for investment attraction as the reliance of Canada's economy on carbon-intensive activities makes it particularly vulnerable to transition risks.

Another area of concern is an inconsistent patchwork of climate disclosure requirements due to Canada's jurisdictional approach to public-equities regulation. Regulators will have to work together to coordinate across provinces, territories and other jurisdictions to ensure consistencies for businesses across the country. A recent review by the Independent Review Committee on Standard Setting in Canada (IRCSS) sought input on the merit of a possible future Canadian Sustainability Standard Board (CSSB) to relate to the ISSB and ensure a two-way flow of information, and potentially, the implementation of the ISSB standards in Canada. The IFRS has also established an office for the ISSB in Montreal so opportunities for alignment and collaboration are ample.

A more comprehensive climate risk disclosure requirement will benefit Canadian issuers in anticipation of more rigorous international standards on the near-term horizon. Alignment is necessary to achieve the CSA's stated goals of: improving issuer access to global capital markets by aligning Canadian disclosure standards with the expectations of international investors; assisting investors in making more informed investment decisions by enhancing climate-related disclosures; facilitating comparable and consistent disclosure; and reducing costs, inefficiency and market fragmentation associated with reporting to multiple disclosure frameworks.