ALLEN & OVERY

ISSB Sustainability Disclosure Standards – challenges in global regulatory implementation and market adoption

Waves of reform to sustainability reporting regimes are only beginning and will gather pace. Much has happened since the first two Sustainability Disclosure Standards were published by the International Sustainability Standards Board (**ISSB**) in June 2023 to form a global baseline of sustainability reporting standards. In September 2023, the ISSB indicated that 30 countries have committed to introduce, or consider introducing, the ISSB Standards into jurisdictional requirements. More reforms can be expected in the wake of the endorsement of the ISSB Standards by the International Organisation of Securities Commissions in July 2023, recent high profile calls for policymakers to consider making ISSB disclosures mandatory by 2025, and the newly published recommendations of the Taskforce for Nature-related Financial Disclosure.

This article reflects on the key trends and challenges arising in global regulatory implementation and market adoption of the ISSB Standards, in anticipation of continued reforms to reporting regimes globally.

The basic context

The first two ISSB Standards are IFRS S1 (*General Requirements for Disclosure of Sustainability-related Financial Information*) and IFRS S2 (*Climate-related Disclosures*). They are effective for annual reporting periods beginning on or after 1 January 2024. Until jurisdictions implement the ISSB Standards into local legal requirements, entities can voluntarily apply these standards.

To assert compliance with the ISSB Standards, an entity must apply IFRS S1 in combination with IFRS S2 and the Sustainability Accounting Standards Board (**SASB**) Standards. As the primary intended audience of ISSB reporting is investors, naturally the information entities disclose about its sustainability-related risks and opportunities must be useful to investors. Each reporting entity has the responsibility and discretion to exercise materiality judgements for all requirements in the ISSB Standards.

The ISSB Standards consolidate several key voluntary initiatives in the present disclosure landscape, including fully incorporating the Task Force on Climate-Related Financial Disclosures (**TCFD**) recommendations. Companies that already report in accordance with the TCFD recommendations, SASB standards and/or GRI Standards are well-placed to build on those foundations.

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Trend towards integrated reporting of climate, nature and other considerations

The first reports under the ISSB Standards will likely focus on climate-related risks and opportunities, as entities may choose to take advantage of the first-year transition relief from the requirement to report beyond climate-related disclosures. However, the demand for broader sustainability-related disclosures is increasing, particularly in the areas of nature, biodiversity, human rights and social considerations. Interest in integrated climate- and nature-related reporting is set to grow, with the recent publication of the Taskforce for Nature-related Financial Disclosure's (**TNFD**) recommendations.[1]

The ISSB will take the TNFD recommendations into account in its ongoing work to simplify the sustainability disclosure landscape. Already, the TNFD recommendations have a high degree of alignment with major existing standards (ISSB, TCFD and GRI Standards), and will inform nature-related reporting standards globally. As the ISSB prepares to confirm its upcoming agenda priorities, it is certain that sustainability reporting requirements will continue to evolve and expand. In the meantime, more entities are starting to consider progressively adopting the TNFD recommendations on a voluntary basis, alongside complying with new jurisdictional reporting requirements which implement the ISSB Standards.

Key challenge: divergent implementation of the ISSB Standards

It would be unrealistic to expect complete homogeneity across sustainability reporting regimes globally. Even with the ISSB Standards serving as a baseline, jurisdictional reporting requirements need to be adapted for local needs. However, the divergence may be minimised if more jurisdictions are convinced of the need to optimise interoperability and ensure a high degree of alignment with the ISSB Standards. It is positive that among the 30 countries that have committed to introduce (or consider introducing) the ISSB Standards into jurisdictional requirements, several have already indicated that they intend to be aligned with the ISSB Standards "*as far as practicable*" (e.g. Australia) or will divert from the global baseline "*only if absolutely necessary*" for jurisdiction-specific matters (e.g. UK).

For reporting entities, the burden of complying with sustainability-reporting obligations may vary across jurisdictions depending on:

- **Incremental requirements that individual jurisdictions may choose to introduce**. For example, the ISSB has no assurance requirements, but the EU Corporate Sustainability Reporting Directive (**CSRD**) provides that limited assurance is required from the date of initial reporting and reasonable assurance, in the future. Incremental requirements may also arise from the broader sustainability regulatory landscape in individual jurisdictions – for example, certain targets and transition plans will only be disclosable under the ISSB Standards if a jurisdiction requires entities to set targets or to have climate transition plans;
- **Types or durations of transition reliefs**. For example, the ISSB anticipates that jurisdictions may choose to provide extended reliefs from the requirements to disclose non-climate related risks and opportunities, to use the GHG Protocol measurement method, and to provide sustainability-related financial disclosures at the same time as related financial statements;
- **Pace and focus of implementation**.[2] The ISSB anticipates that jurisdictions will generally introduce the ISSB Standards on an accelerated basis for publicly accountable entities falling within prime, premium or senior market tiers, as compared to entities within a standard market tier; and
- **Materiality perspectives**, as discussed below.

It remains to be seen to what extent sustainability reporting requirements will diverge across jurisdictions. The International Organisation of Securities Commissions' endorsement of the ISSB Standards is a significant catalyst for its 130 member jurisdictions to consider how they can incorporate the ISSB Standards into their regulatory frameworks, and the world's second biggest economy, China, has expressed commitment to supporting the work of the ISSB and the development of global sustainability disclosure standards.

Reporting entities and investors alike will benefit from standard setters providing guidance materials focused on clarifying the interoperability of standards across different jurisdictions. A good technical understanding of the applicable reporting standards will be necessary to navigate the complexities of multiple legal reporting regimes and to minimise duplicative efforts.

1 The TNFD recommendations (published on 18 September 2023) are intended to promote a shift in the mindset and behaviour of companies and financial institutions through the reporting of clear, comparable and consistent nature-related disclosures.

2 For example, the UK Sustainability Disclosure Standards (SDS) are due to be created by **July 2024** based on the ISSB Standards. The UK SDS may be referenced in legal or regulatory reporting requirements. Notably, in **H1 2024**, the FCA intends to consult on updated disclosure rules referencing the UK SDS and new guidance on transition plan disclosures, among other topics. The FCA's updated disclosure requirements are expected to come into force for accounting periods beginning on or after **1 January 2025**.

Key challenge: differences in materiality perspectives

The ISSB is focused on serving investors' needs and therefore takes a single materiality perspective, which requires an entity to disclose how sustainability issues impact on the entity ("outside-in"). However, different jurisdictions may approach the issue of materiality differently. Most notably, the European Sustainability Reporting Standards (**ESRS**), the standards required pursuant to the EU CSRD, take a double materiality perspective, i.e. they require an entity to disclose its impacts on people and the environment ("inside-out"), in addition to "outside-in" disclosures.

Drawing a line between "outside-in" impacts and "inside-out" impacts is challenging, particularly as they are often inter-related. The inter-connectedness of the two types of impacts has most recently been recognised by the TNFD, which "*strongly recommends*" that irrespective of the approach to materiality, reporting entities should identify and assess the entity's dependencies and impacts on nature and the nature-related risks and opportunities for the entity, and explain the links between them. Distinguishing between the two types of impacts would also likely be particularly challenging for human rights matters.

Thus, in applying the ISSB Standards, there may be situations where an entity decides to also consider "inside-out" impacts because they might result in "outside-in" impacts which are reportable under the ISSB Standards. In support of this approach, several asset owners have recently opined that the ISSB's materiality concept should be extended or clarified to include "inside-out" impacts, irrespective of their financial impacts.

Investors will continue to face the challenge of engaging with the subjective materiality assessments undertaken by each reporting entity. As mentioned, each reporting entity has the responsibility and discretion to exercise materiality judgements. Each has its own set of stakeholders to engage with to identify unique impacts for disclosure. The short-, medium- and long-term horizons over which sustainability-related risks and opportunities may occur can also vary between entities.

Key challenge: variations in industry-specific disclosures

The ISSB Standards are expected to enhance the comparability of disclosures by entities within the same industry, particularly through industry-specific disclosures. However, the range of disclosures provided will almost certainly vary across entities: it is incumbent on each entity to consider the full range of climate-related risks and opportunities it faces, and it is for each entity to determine which industry-based metrics are material. There may be unique aspects of an entity's business model or circumstances giving rise to specific risks or opportunities. Therefore, only a subset of the full range of disclosure topics and metrics is likely to apply to any entity.

The ISSB's industry-based guidance for climate-related disclosures serves as a useful starting point, which allows entities within the same industry to focus on the issues that may be most significant to that industry. However, the guidance is non-exhaustive. Entities will need to stay updated with industry practice and ongoing developments in relevant industry-specific disclosure standards. In the near term, the ISSB plans to update the non-climate SASB Standards content in December 2023, having already aligned the climate-related content in the SASB Standards with IFRS S2. A broader overhaul of the SASB Standards may also be considered in due course, to improve interoperability with the GRI Standards and the upcoming sector-specific ESRS.

Key challenge: Scope 3 disclosures

IFRS S2 requires an entity to disclose its Scope 1, 2 and 3 greenhouse gas emissions measured in accordance with the *Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard (2004).* Additionally, an entity that participates in asset management, commercial banking or insurance is required to disclose certain specific information about its 'financed emissions' which are associated with the entity's investments. Given the lack of reliable, verifiable data on GHG emissions, the requirement to disclose Scope 3 GHG emissions is widely perceived as a significant challenge for financial institutions in particular. We anticipate future regulatory intervention aimed at addressing the uncertainty around the methodologies used to generate and report scope 3 GHG emissions data (e.g. the UK government is due to launch a consultation on this topic).

The disclosure of Scope 3 GHG emissions is intended to increase comparability for investors, considering that a company's prospects are impacted by the evolving regulation around GHG emissions, regardless of where the emissions take place along a value chain. However, reporting entities have to grapple with the difficulties of deciding which Scope 3 categories and entities to include in measuring Scope 3 GHG emissions. The entire value chain (upstream and downstream) must be considered. Entities should refer to the detailed Scope 3 measurement framework set out in IFRS S2 for further guidance, and consider whether they may benefit from the proportionality mechanisms provided in the ISSB Standards.

Key challenge: trade-offs between comparability and proportionality

The ISSB Standards incorporate two proportionality mechanisms, which will provide some relief for reporting entities:

– An entity shall "*use all reasonable and supportable information that is available to the entity at the reporting date without undue cost or effort*". This approach applies particularly when an entity identifies its material sustainability-related risks and opportunities, determines the scope of its value chain in relation to each of those risks and opportunities, and measures Scope 3 greenhouse gas emissions.

– An entity's disclosure shall be limited by the "*skills, capabilities or resources*" it has to provide certain information. For example, instead of quantitative information, an entity might disclose qualitative climate-related scenario narratives to reflect its climate resilience, and qualitative information about the anticipated financial effects of a sustainability-related risk or opportunity.

However, it remains to be seen whether the mechanisms achieve a worthy trade-off between attaining comparability of disclosures for investors and reducing the reporting burden for entities. It will also likely be challenging for authorities to monitor whether these mechanisms are being applied appropriately.

Closing thoughts

As the market gains familiarity with the ISSB Standards, it will become apparent whether the implementation of the ISSB Standards across the globe will result in greater ease for reporting entities and for investors seeking to compare sustainability-related features and performances. Despite the expected increase in standardisation of sustainability reporting requirements globally, sustainability disclosures will necessarily be highly tailored to the circumstances and materiality assessments which are unique to each reporting entity, as well as the implementing jurisdiction. Aligning disclosure practices with investors' informational needs and the world's sustainability-related needs will require continued engagement among the ISSB, jurisdictional authorities, reporting entities, investors and other stakeholders.

Should you have any questions on the matters discussed in this article, please get in touch with the authors Matthew Townsend (Partner), Ying-Peng Chin (Senior Knowledge Laywer) or Danae Wheeler (Associate), or your usual contact at Allen & Overy LLP.

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