July 27, 2022

International Sustainability Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London, E14 4HD

Re: ISSB consultations IFRS S1 (General sustainability requirements) and IFRS S2 (Climate requirements) - Response provided by the IACPM

Dear Mr. Faber,

The **IACPM** (International Association of Credit Portfolio Managers) is a global industry association established in 2001 to further the practice of credit exposure management by providing an active forum for its member institutions to exchange ideas on topics of common interest.

The IACPM's institutional member firms comprise the world's largest financial institutions and include next to banks (lenders) also investors, insurers, and reinsurers, which participate in credit risk transfer transactions as buyers of credit assets or credit protection sellers. The IACPM represents the teams within those financial institutions who have responsibility for managing portfolios of loans, bonds, or similar credit sensitive financial instruments, including defining credit strategies, actively controlling concentrations, adding diversification, managing the return of the portfolio relative to the risk, allocating capital to new lending and, finally, defining the portfolio transition path to sustainability. As such, the IACPM can provide a unique perspective which can be different from those of other financial industry associations.

In carrying out responsibilities successfully, credit portfolio managers contribute to maintaining the safety and soundness of their respective financial institutions. Effective credit portfolio management is critically important to our prudential supervisors and to policy makers more broadly because of its role in supporting financial institutions' ability to lend. Therefore, the IACPM is regularly engaged with global and regional regulators (in the EU, the UK, US, APAC, and Asia) on matters relating to financial stability, sustainable finance, and credit capital markets.

The IACPM welcomes the ISSB initiative to develop a comprehensive global baseline of sustainability disclosures for the capital markets, and to consult on the first two proposed standards for general sustainability-related and for climate-related requirements. ISSB consultations have triggered a massive amount and a large variety of feedback from all types of stakeholders interested by the challenge of transparency on cross-border sustainability value. We drafted this **comment letter** to provide **feedback tailored to the specific needs and objectives of credit portfolio managers in banks, asset management and credit insurance**.

Recommendation 1: Prioritize on scope and principles-based alignment among the main jurisdictions on a global baseline, before proposing prescriptive standards.

- Assuming ISSB will become the international standard, acting as an effective **global baseline** (and not as a global ceiling), alignment of discrepancies or differences with other regional standards should be a key priority to ensure that sustainability reporting remains consistent and progressive within the boundaries of the Global Baseline Report.

- In the interim, the ISSB should remain a principles-based approach, and transform into prescriptive standards when full alignment or mapping is achieved with the main stakeholders, jurisdictions and standards-setters on the purpose, architecture, entity-specific metrics, usage of SASB industry-specific guidance, and boundaries of sustainability reporting standards, e.g.:
    - With EFRAG, on materiality matrix, materiality definition (from an impact and an enterprise value creation perspective~~s~~), terminology (e.g., "taxonomy" definition, "significant" risks, and opportunities), etc.
    - With SEC, on a workable materiality threshold (the current 1% proposal is not practical) and the treatment of derivatives as a separate building block after lending and investments.

- The same architecture **with a single global standard baseline report and additional building blocks**, should be applicable in all jurisdictions. This will allow jurisdictions – if appropriate to the nature of their economy and sustainability challenges - to add complementary building blocks outside the baseline, e.g.:
    - A baseline with external materiality limited to investors (the "enterprise value creation"), allowing to add a building block for all other stakeholders (the "impact" materiality).
    - A baseline with a materiality threshold acceptable to all parties but allowing SEC to request an additional report down to the locally agreed threshold.

- We recommend the ISSB to consider providing examples to demonstrate how the standards act as a global baseline that can interoperate effectively with additional jurisdiction-specific requirements via a 'building blocks' approach. This could be achieved by providing a **mapping between all terms, boundaries, metrics, and requirements between the main jurisdictions, starting at least with ISSB, GRI, EFRAG, and SEC.**

Recommendation 2: Gradual implementation, considering data limitation

- **Flexibility** should be allowed for until principles and requirements are aligned or clearly mapped across the main jurisdictions for a single and consistent global baseline.

- This global baseline should enable insights, in the general requirements, into how corporations and institutions are dealing with a possible **trade-off between the E-S-G components of sustainability.** This is, because – contrary to the EU for example - the ISSB did not decide on a taxonomy that defines what is sustainable, i.e., the technical screening criteria for activities that can make a substantial contribution to one sustainability goal (e.g., climate change mitigation and adaptation), while avoiding significant harm to the four environmental and social objectives (sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention control, and protection and restoration of biodiversity and ecosystems).

Therefore, it is particularly important for carbon-intensive activities like Oil & Gas, to understand how GHG emissions can be reduced in the portfolio of products (of each corporation) and the lending portfolio (of each financial institution), without harming e.g., biodiversity, human or social capital.

- ISSB standard setters should acknowledge that the impact assessment, even for the first proposed "Climate" report, will be **incomplete on GHG emissions** reporting because:
    - More granularity and protocol standardization (i.e., PCAF) will be necessary to avoid double counting at portfolio level, as the scope 3 emissions of some borrowers are the scope 1-2 emissions of other borrowers in the same credit portfolio.
    - Some sectors with high GHG intensity are more advanced (and relevant) than other sectors, and credit portfolio managers will focus in a first step on mitigating these high concentrations in financed GHG emissions.
    - Financial institutions are not ready to report scope 3 emissions.

<u>Recommendation 3</u>: Time lag between first reporting deadlines for corporations and for financial institutions

- Financial institutions reporting is dependent on the data received from borrowers. To be practical and achievable, the ISSB should allow for a **one-year lag** between the first reporting deadlines for corporations and for financial institutions, so that financial institutions can put the data infrastructure in place to enable reporting, ensure data quality and develop the necessary proxies.

- Being at the center of the economy with an important role to play in the transition, banks and investors need to have their own data and view as well. If **proxies** are used for external reporting, they should be standardized per (sub)industry or activity (refer to the EU taxonomy), with an indication of the data quality underlying the estimates.

<u>Recommendation 4</u>: Financed emissions. Decision usefulness of the metric

- The metrics used to estimate financed and facilitated emissions are continuing to develop and vary, but the ability to see how portfolios are changing annually can assist banks with information before engaging with **each client** about their transition plan.

- At the **portfolio** level, the capacity to reduce the same volume of financed emissions will depend on the transition path of each specific sector and where each company stands in this transition. Thus, although relevant, this metric – if used in external reporting - should be complemented by a **perspective on the difficulty to mitigate**, so that investors can make the appropriate judgement. This might be achieved by estimating the expected % reduction of financed emissions over a 5- or 10-year time horizon, per unit of exposure and industry bucket.

- Guidance would be helpful on the **methodology to calculate financed emissions**: A more criteria-based target-setting approach would probably work for capital market instruments facilitation, while for on-balance-sheet activities and thus financed emissions, a sectoral pathway approach would fit better.
- From a risk perspective, we would need to consider the committed undrawn amount of revolving credit facilities or the **Expected Exposure At Default** (not the regulatory worst case EAD) to estimate the facilitated emissions during the expected transition plan. Guidance should be

provided on the calculation of facilitated emissions.

- **Standardizing the methodologies** (e.g., using PCAF) would be very helpful as financial institutions will have to consistently estimate and aggregate both financed and facilitated emissions across various borrowers, asset classes, industries, and geographies.

<u>Recommendation 5</u>: Financed emissions. Clarify treatment of risk mitigants in lending portfolios

- Depending on the asset class, bank loans are protected by **credit risk mitigants** like collateral or protections purchased from third parties at single loan, single borrower, or portfolio level, by e.g.:
    - financial and/or physical collateral, like on mortgages or loans granted to households and SMEs,
    - financial guarantees or insurance policies, like in trade finance operations,
    - private credit insurance policies, like on loans granted to SMEs, mid-corporates in excess of the risk appetite,
    - credit default swaps, like for drawn and undrawn exposures to large corporates in excess of concentration limits,
    - synthetic securitizations, like for portfolios of homogeneous asset classes of retail or corporate loans, etc.

    Illustration: A loan to a transport company, collateralized by inventories made mostly of fuel reserves, or a loan to an oil and gas company, collateralized by a portfolio of green bonds: which emissions are banks financing?

- Some ESG risks (like climate physical risks) can be mitigated by **climate risk mitigants** purchased from (re)insurance companies, while carbon emissions can also be mitigated by **carbon offsets.**

- To provide a fair view on financed and facilitated emissions, clarity should be provided on the eligibility and treatment of the various types of credit and climate risk mitigants and of carbon offsets commonly used by credit portfolio managers.

<u>Recommendation 6:</u> Financed emissions. Phase-in of derivatives

Financial institutions are closing derivatives transactions with clients and with market counterparties. We recommend that derivatives books of financial institutions are excluded from the first baseline calculation of financed emissions, which should be limited to the assets held on the balance-sheet.

We recommend that derivatives are treated in another building block, after lending and investments.

Accordingly, emissions embedded in posted/received collateral from derivatives contracts should be excluded from the first baseline, as long as the firms do not take ownership of this collateral, then captured under the equities or corporate bonds (PCAF) asset classes.

We appreciate the ongoing discussions between the IACPM and the ISSB and remain available to discuss the content of this comment letter, as well as any other sustainability-related topics relevant for our members in banking, credit insurance, and credit investment management.

Yours Sincerely,

Som-Lok Leung
Executive Director
International Association of Credit Portfolio Managers (IACPM)