

IRSG response to call for evidence on UK greenhouse gas emissions reporting: Scope 3 emissions

About the IRSG

The International Regulatory Strategy Group (IRSG) is a practitioner-led body of leading UK-based representatives from the financial and professional services industry. It is an advisory body to the City of London Corporation, and to TheCityUK. The IRSG develops its policy positions through a number of workstreams which comprise representatives from across the industry to ensure a cross-sectoral response. Its remit is to provide a cross-sectoral voice to shape the development of a globally coherent regulatory framework that will facilitate open and competitive cross-border financial services.

The IRSG welcomes the opportunity to contribute the following comments, in response to the call for evidence of the UK Department for Energy Security & Net Zero (DESNZ) on the benefits, costs, and practicalities of Scope 3 greenhouse gas (GHG) emissions reporting in the UK.

Key points

- **We welcome the UK government support for the development of international standards for the disclosure of sustainability-related information.**
- **We agree with the approach to Scope 3 reporting contained within IFRS S2 and are also broadly supportive of the ISSB's approach to materiality. We support full alignment with this approach under UK reporting rules, though we note that there are areas of the ISSB disclosure framework that require clarification, and others that require flexibility in application.**
- **We believe that the use of the GHG Protocol for the purposes of Scope 3 reporting within IFRS S2 will lead to comparable and consistent reporting that is useful for investors and users of accounts, but reporting entities should be allowed to apply the Protocol flexibly.**
- **We believe that Scope 3 emissions reporting would be beneficial to market efficiency and discipline, but we caution the Government against conflating Scope 3 emissions with transition risk.**

In responding, we would like to highlight the following comments from our members:

Full alignment with the global baseline

We welcome the UK government support for the development of international standards for the disclosure of sustainability-related information and agree with the government that the provision of

globally comparable sustainability-related information is vital for the effective functioning of capital markets.

It is of utmost importance that we build an effective international framework for sustainability-related disclosures, which will avoid fragmentation and regulatory arbitrage, promote greater transparency, consistency, comparability of disclosures, and reduce reporting costs and operational burdens.

We believe that jurisdictional approaches to sustainability information should converge around the ISSB baseline standards, which could form the basis for counterparty information required to meet sustainability disclosure requirements for international companies. We therefore consider integrating all aspects of the ISSB Standards into the UK's domestic reporting and disclosure framework to be of vital importance.

To retain its place as a green financial centre in the future, the UK government should drive momentum towards the interoperability of global sustainability requirements, pursuing convergence wherever possible to avoid fragmentation. It should support the ISSB in its efforts to create a uniform and mandatory approach to disclosure. In addition, the government should work with its counterparts in the EU to learn lessons from their experience and to encourage further convergence with the ISSB approach as the EU sectoral and third country standards are developed.

Scope 3 Reporting within IFRS S2

We agree with the approach to Scope 3 reporting contained within IFRS S2 and are also broadly supportive of the ISSB's approach to materiality and support alignment with this approach under UK reporting rules.

Scope 3 emissions reporting would provide valuable insights to investors by helping to generate higher quality emission footprint disclosures, increasing transparency of reporting entities' progress towards meeting decarbonisation targets, and improving comparability of emissions across sectors. But we caution the Government against conflating Scope 3 emissions with transition risk. GHG emissions metrics based on absolute emissions, which indicate the total amount of GHG emissions of a firm or of its broader value chain over a given period, do not take account of the scale of a reporting entity's activities and are affected by factors unrelated to their transition risk (such as changes in their market share). Moreover, they are also backward-looking and give only a limited insight into future changes in a firm's business model. As such, they need to be combined with other data for fair interpretation and cannot by themselves be interpreted as a risk metric.

Separately, we would welcome guidance on which type of Scope 3 emissions should be regarded as material, given ambiguity in the approach to materiality under the ISSB disclosure framework. Specifically, the S1 and S2 Objectives both state that the focus of disclosure should be on information that could affect cash flows and access to / cost of capital, but S1 then defines material information in

terms of information that could reasonably be expected to influence decisions of primary users of general purpose financial reports (Para. 18 and Appendix A). This creates unclarity about application, since Scope 3 financed emissions may have negligible financial impact to the reporting entity over the short, medium and long-term but, at the same time, may be pertinent to certain users' decision-making.

In general, there should be greater emphasis on reporting the most material Scope 3 categories in a specific sector to make Scope 3 disclosures meaningful. In particular, we note that a significant volume of Scope 3 reporting from companies omits reporting in the most material Scope 3 categories in its sector, resulting in significant underreporting and making it difficult to compare data across companies. We recommend that the UK authorities work with ISSB to publish such guidance to ensure international interoperability.

Transparency around the use of estimates

Until the ISSB standards are mandatory for a majority of companies worldwide, we expect the majority of Scope 3 emissions reported to be based on estimates. As the market matures, we believe that more companies will use a hybrid methodology (incorporating both estimates and primary data from suppliers), before eventually moving to Scope 3 being majority primary data driven. In this situation, what seems important to us is to ensure transparency about the estimates used, their methodologies and the assumptions made.

The GHG Protocol

We believe that the GHG Protocol is the best standard for Scope 3 reporting available today. The guidance is comprehensive, and the website provide a set of tools to support companies in their Scope 3 emissions reporting. The IRSG therefore believes that the use of the GHG Protocol for the purposes of Scope 3 reporting within IFRS S2 will lead to comparable and consistent reporting that is useful for investors and users of accounts. That said, we do not think that the use of the GHG Protocol, or any other specific framework, should be prescribed by Government or regulatory bodies, especially when the framework in question has limitations (as with the GHGP). Instead, reporting entities should be allowed the flexibility to adapt the GHG Protocol to reflect specificities in their business models, and disclose those adaptations.

SECR

We believe that the UK's Streamlined Energy and Carbon Reporting (SECR) regulations are achieving their original objectives. In order to help companies align with these objectives we would recommend, to provide a set of tools and detailed guidance to better report upstream and downstream emissions.

For any questions or clarifications please contact: IRSGsecretariat@cityoflondon.gov.uk