Issue 32:
July 2024

Creating a climate of change digest

Climate risk regulatory developments in the financial services industry

Leading off

On April 25, 2024, the US Department of the Treasury, and the Internal Revenue Service (IRS) released final rules on transferability, a key Inflation Reduction Act (IRA) provision that expands the availability of capital to advance the US clean energy transition.[1]

The IRA created two new tax credit delivery mechanisms for businesses to access clean energy tax credits — elective pay (also known as direct pay) and transferability. Transferability allows entities that cannot use elective pay but do qualify for an eligible tax credit to transfer all or a portion of the credit to a third-party buyer in exchange for cash.[2] Governments, different types of tax-exempt organizations, and other entities can fully benefit from IRA tax credits by using these credit delivery mechanisms.

Earlier, clean energy project owners had to form tax equity partnerships with investors to receive the full value of credits like the investment tax credit (ITC). Project owners without sufficient tax liability were previously unable to realize the full value of credits, which raised costs and created challenges for financing projects. However, IRA's transferability provisions allows businesses to transfer all or a portion of any of 11 clean energy credits to a third party in exchange for tax-free immediate funds, so that businesses can take advantage of tax incentives if they do not have sufficient tax liability to fully utilize the credits themselves.[3]

On April 30, 2024, the International Sustainability Standards Board (ISSB) published the International Financial Reporting Standards (IFRS®) Sustainability Disclosure Taxonomy (ISSB Taxonomy) to enable investors and other capital providers to analyze sustainability-related financial disclosures efficiently.[4]

The ISSB Taxonomy was created to reflect the disclosure requirements arising from the IFRS Sustainability Disclosure Standards - IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information[5] and IFRS S2 Climate-related Disclosures,[6] issued in June 2023. The ISSB Taxonomy includes elements for tagging sustainability-related financial information prepared in accordance with these standards, making it machine-readable and facilitating efficient extraction, comparison, and analysis of such information.

The IFRS Sustainability Disclosure Taxonomy is a digital taxonomy that entities can use to consistently and comparably classify and structure sustainability-related financial information. The taxonomy is designed to support the digital reporting of sustainability-related financial information globally, enabling users of general-purpose financial reports to consume this information digitally. It also helps regulators that require the digital reporting of sustainability-related financial information and allows entities to tag information about their sustainability-related risks and opportunities in their general-purpose financial reports without undue cost.

Additionally, the ISSB Taxonomy supports interoperability with other sustainability-related disclosure standards, facilitating digital comparisons of sustainability-related financial information prepared in accordance with different standards. The taxonomy performs a similar role to the IFRS Accounting Taxonomy in relation to IFRS Accounting Standards, providing a framework for consistently and comparably classifying and structuring sustainability-related financial information.

The ISSB aimed to strike a balance between creating elements that would result in information tagged being neither too broad for efficient analysis by users of general-purpose financial reports nor too narrow to allow such users to understand the broader context for that information. The taxonomy includes categorical elements for sustainability-related metrics and targets, such as Boolean and extensible enumeration elements, to standardize narrative disclosures. The taxonomy includes a hierarchical structure for tagging sustainability-related financial information, which reflects the order of disclosure requirements in the IFRS Sustainability Disclosure Standards.

On May 2, 2024, the European Sustainability Reporting Standards (ESRS)-ISSB Standards Interoperability Guidance document, published by the European Financial Reporting Advisory Group (EFRAG), provided detailed recommendations for ensuring the interoperability of Environmental, Social, and Governance (ESG) reporting standards.[7]

The joint interoperability guidance aims to describe the alignment of climate-related reporting disclosure requirements and information that an entity needs to know to enable compliance with both ESRS and ISSB standards, ensuring interoperability between them.

The guidance is structured into four main sections. Section 1 addresses interoperability at the level of general reporting requirements, including beyond climate. Sections 2, 3, and 4 focus on interoperability for climate-related disclosures from two perspectives:

- Entity applying ESRS that wants to meet all climate-related disclosure requirements in IFRS S2 Climate-related Disclosures and apply relevant requirements in IFRS S1.
- Entity applying ISSB Standards that wants to meet all disclosure requirements on climate change in ESRS E1 and apply relevant requirements in ESRS 1 and ESRS 2.

The guidance highlights the high level of interoperability achieved in relation to climate between ESRS and the corresponding disclosure requirements in ISSB Standards. It presents in a tabular form the paragraphs in ISSB Standards and the corresponding paragraphs in ESRS, where intersecting disclosure requirements can be identical (common), cover at least the disclosure requirements in IFRS S2 while providing incremental disclosures, or be unique to ESRS 1.

The guidance does not include non-mandatory disclosures, non-mandatory calculation guidance, or formal statements of equivalence, which is in the remit of public authorities; rather, the goal of this interoperability guidance is to increase efficiency for entities that report under both sets of standards, reducing complexity, fragmentation, and duplication.

On May 9, 2024, the Federal Reserve Board of Governors (FRB) released the summary of the exploratory pilot Climate Scenario Analysis (CSA) exercise that was announced in September 2022 with six of the largest US banks.[8]

Six banking organizations participated in FRB's pilot CSA exercise and submitted qualitative and quantitative information about their climate risk-management practices to FRB by July 2023. The CSA exercise was exploratory in nature and the FRB has now published a summary report outlining results from this exercise and emphasizing the varying approaches adopted by the banks to manage and assess the financial impacts of climate-related risks on their operations.

The summary report includes the following sections:[9]

1. **Overview of the Pilot CSA Exercise**, which discusses the transmission channels through which climate-related risk drivers could impact large banking organizations and describes the overall design of the pilot CSA exercise.
2. **Pilot CSA Exercise Insights**, which summarizes key takeaways from the exercise related to participants' climate-related financial risk-management practices, exposures to climate-related risks, and lessons learned.
3. **Physical Risk Module**, which looks in detail at participants' approaches to physical risk scenario design, measurement methodologies, and estimates.

4. **Transition Risk Module**, which looks in detail at participants' approaches to transition risk scenario design, measurement methodologies, and estimates.
5. **Governance and Risk Management**, which discusses participants' governance and risk management processes.
6. **Appendix**, which provides notes on calculation methodologies.

While the CSA was exploratory and bore no direct capital implications, it has set the stage for ongoing engagement between the Federal Reserve and participating banks. The insights garnered will inform future regulatory guidance and could potentially shape the development of standardized practices for climate risk assessment in the financial sector.

The Federal Reserve plans to continue collaborating with these institutions to refine their capabilities in measuring and managing climate-related financial risks. This is expected not only to enhance the resilience of individual banks but also bolster the overall stability of the financial system in the face of environmental changes.

On May 9, 2024, the Science Based Targets initiative (SBTi) released the Terms of Reference for the upcoming revision of the Corporate Net-Zero Standard.[10]

The SBTi is undertaking a revision of the Corporate Net-Zero Standard to strengthen the Standard using the latest leading practices on corporate climate target-setting to enhance validations of net-zero targets and to increase the overall transparency and credibility of the SBTi.

The Terms of Reference[11] document describes key information related to this revision, such as project objectives, the steps for developing the revised Corporate Net-Zero Standard, the interim and final deliverables of the revision project, the proposed timeline for the revision, and the potential opportunities for stakeholder involvement during the standard revision process.

The revision project, titled Corporate Net-Zero Standard V2.0, follows the Standard Operating Procedure[12] (SOP) for the Development of SBTi Standards. The update is in line with the SOP's regular review cycle, which mandates revisions every two to five years. The SBTi has also launched a Project Feedback Form[13] allowing stakeholders to provide their feedback throughout the standard revision process.

The revision of the Corporate Net-Zero Standard is centered around the below four goals:[14]

1. To align with the latest scientific thinking and best practices, such as from the Intergovernmental Panel on Climate Change[15] (IPCC) and the UN Secretary General's High Level Expert Group on the net-zero emissions commitments of non-state entities (HLEG);[16]
2. To address challenges related to Scope 3 target setting and implementation;
3. To integrate continuous improvement and target delivery; and
4. To improve structure and enhance interoperability with other SBTi standards as well as other relevant external frameworks and standards.

The final draft of the Corporate Net-Zero Standard V2.0 is expected to be published in Q4 2025 and the complete details to support entities in conforming to the Corporate Net-Zero Standard V2.0 will be communicated in a timely manner before its launch.

Additional Deloitte US perspective on climate risks

For additional insights, please see our ongoing series on how climate risks are shaping US financial regulatory initiatives and the impact these developments may have on the financial services industry and the broader economy:

- 2024 financial services industry outlooks
- Deloitte 2023 CxO Sustainability Report
- Ingraining sustainability in the next era of ESG investing
- The CIO's call to action: Driving an environmentally sustainable tech agenda to accelerate organizational change
- Climate change and financial risk digest | Deloitte US
- Center for Regulatory Strategy - Sustainability, climate & equity | Deloitte US

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Endnotes

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13. SBTi, "Corporate Net-Zero Standard V2.0 Feedback Form," May 9, 2024.
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15. The Intergovernmental Panel on Climate Change, "Sixth Assessment Report," 2023.
16. United Nations' High Level Expert Group on the Net-Zero Emissions Commitments of Non-State Entities, "Integrity matters: Net-zero commitments by businesses, financial institutions, cities and regions," 2022.