Sustainable finance and net zero targets

The role of standards

On December 4, at COP28 the International Organization for Standardization (ISO) hosted a roundtable of organizations representing financial institutions, public bodies and the private sector to discuss the significance of standardization for sustainable finance. This event examined how assurance and verification standards can contribute to climate protection.

The key themes included:

- Using sustainable finance standards for transparency and accountability in achieving the 2050 net-zero goals
- Harmonizing assurance and verification practices for consistency and alignment among financial institutions and markets
- Exploring future standards, prospects and challenges in the coming years

ISO understands standards to be the distilled wisdom of people with expertise in their subject matter and knowledge of the needs of the organizations they represent. ISO standards are internationally agreed by experts, with the aim of standardizing practice to one baseline and bringing organizations from all over the world together in a consistent vision.

This paper covers the main points expressed during the roundtable, which can be viewed in full[1] via the ISO's COP28 programme[2].

Using sustainable finance standards for transparency and accountability in achieving the 2050 net-zero goals

Collaboration and establishing common ground between standards bodies, organizations and nations is key to the sustainability transition that capital markets are facing. ISO standards and IFRS form an important link in gathering data for disclosures and other global reporting requirements.

In June 2023, the International Financial Reporting Standards (IFRS) Foundation via the International Sustainability Standards Board (ISSB) issued its first two standards – IFRS S1 and IFRS S2, both focused on climate related disclosures[3]. Following endorsement from the global securities regulator International Organization of Securities Commissions (IOSCO), global adaptation of IFRS S1 and S2 are now the focus of IFRS.

ISO standards support consistent approaches for the management of sustainability-related matters and, as such, ISO is cooperating with IFRS to establish a truly global baseline of sustainability-related financial disclosures, allowing for better information for better decisions around sustainable finance. At COP28, ISO and the IFRS Foundation confirmed their shared commitment to cooperate to support efficient and resilient global economies.

ISO and IFRS are committed to advancing capacity building initiatives that focus on supporting organizations to build internal expertise and understanding to advance practices and sustainability reporting. In particular, the ISO 14000-suite on environmental management can assist in gathering via management systems the data needed to support IFRS S1 and IFRS S2 disclosures[4]. Companies that have implemented such robust management system standards will be well placed to communicate with investors using the ISSB Standards.

By its nature information is adversarial in that institutions, whether financial or other, are looking to present themselves in the best light in order to maximize their value, lower the cost of their capital and grow their market share. Standards have a key role to play in this arena as they would assess the validity and extent of any organization's climate and net zero claims in a clear and comparable way.

As is the case with financial standards, any standards concerning sustainability need to have a common language and to work across markets. Some organizations will need more support in relation to standards, as it has to be recognized that SMEs, micro-companies and some financial institutions work in difficult markets, particularly those that are emerging, and that the legislative environment is not the same everywhere. Standards around sustainable finance need to take these differences into account to be usable across the board.

Looking at climate from a financial risk perspective can also provide continuity when traditional standards bodies might be paralyzed by different governments or administrations' political priorities. The Networking for Greening the Financial System (NGFS) has set out guidelines for climate risk management by financial institutions and have developed climate scenarios which assess the various risks associated with, for example, a 1.5-degree temperature rise. Such 'coalitions of the willing' are able to manage standardization during periods of polarization and fracture.

The European Commission has been working on aligning finance flows to the goals of the Paris Agreement, setting in place a framework in Europe that the Commission hopes will have similar global impact to the General Data Protection Regulation (GDPR)[5], acting as a global standard which pulls companies around the world who want to trade with the bloc to an operating baseline.

This framework has three parts:

- The EU-Taxonomy which defines what a 'sustainable' activity is, underpinned by the principle of 'do no significant harm'.[6]
- Disclosure, with the Corporate Sustainability Reporting Directive (CSRD) entering into force in the EU at the beginning of 2023. Being rooted in the CSRD, 2024 marks the rollout of the European Sustainability Reporting Standards (ESRS) across the EU. These look not just at the impact of climate or environment on the company itself, but also the active and practical contributions companies make that improve climate change outcomes or, indeed, worsen them.
- Instruments and tools such as the European Green Bond[7] standards published in November 2023, which are built on international good practice. It's hoped these instruments will demonstrate how the taxonomy can help raise capital in practice for the transition and for climate action.

In 2019 the European Investment Bank made a commitment to transition to become a climate bank with 50% of its minimum financing as green investment by 2025[8][9], a target it achieved in 2023, two years ahead of time[10]. The goal is to mobilize a trillion Euros of green investment in Europe and globally by 2030.

The bank is converging with the EU Commission's taxonomy, implementing in line with what they describe as a Paris aligned framework to support their clients – in particular, high emitters, taking guidance on the 'do no significant harm' principle – to decarbonize and to come to terms with standards and regulatory compliance. This 'Climate Bank Roadmap' will be the playbook for the bank's green transformation, with standards and policy guiding the bank's activities, first by establishing green definitions on how to report and track green activities in line with the taxonomy and complying with Paris-aligned criteria, and then beyond this, supporting clients with the CRSD and ESRS with the goal of issuing a green standard compliant bond.

Harmonizing assurance and verification practices for consistency and alignment among financial institutions and markets

As organizations begin to come to terms with climate risks and opportunities and start defining their net zero targets, transition plans are of growing importance in ensuring the delivery of the strategies that underpin these. At present, companies are able to present varying levels of detail around these plans, but standards would create a setting where information is consistent, comparable and comprehensible across firms and jurisdictions.

Standards enable comparison between entities, allowing for measurement of performance. With performance measurement comes benchmarking, which then raises good practice as organizations aim to better appeal to potential investors. Clear defining rules such as the European Commission's taxonomy give investors clear guidance on what is green and what is not.

The Transition Plan Taskforce[11] has been working on this in the UK with a broad coalition of stakeholders including standard setting bodies, private sector and academia to develop a good practice framework that sets out what consistent disclosures look like to ensure that investors have the relevant information about company level transition plans. Sector-specific guidance is in open consultation at the moment, across seven sectors – asset managers, asset owners, electric utilities and power generators, food and beverage, metals and mining, and oil and gas.[12]

From a consumer perspective, the UK's Financial Conduct Authority has recently launched a Sustainability Disclosure Requirement[13] labelling regime restricting how asset managers name and market their funds to consumers. Consumers thus have greater clarity around what defines 'green' financial products. The German Institute for Standardization (DIN) is also classifying financial products on their 'shades of green' to guide consumers in making sustainable choices.

For investors, the variety and complexity of different standards and regulations has historically created something of an 'alphabet soup' that's challenging to navigate. This is changing, and with a speed that is previously unknown in the international regulatory community, with capacity building programmes that to try to push out adoption at a faster rate than the world has ever seen before. Nevertheless, it's an extremely difficult and complicated process, with many difficult steps to go. In spite of the multiplicity of bodies working on standards, they needn't be in competition with one another. There is space for people to define what the outcome is at a global level, at a jurisdictional level, and at a sectoral level, with complementarity between the organizations active in this space.

Alignment between standards is key to a global common language in transition. Standards make comparison possible, which in turn allows for measurement, which ultimately enables benchmarking, incentivizing organizations to become best in class, increasing the appeal to the investor. ISO standards can help to operationalize IFRS S1 and S2, going beyond that, ISO standards can also underpin the European CSRD. An agreement in principle between has been reached EFRAG and CEN-CENELEC (European Committee for Standardization) to use existing ISO and CEN standards as guidance to the application of the

European Sustainability Reporting Standards (ESRS).

Replicable frameworks, platforms and methodologies are vital for the sustainable transition. The EDGE green building framework[14] is a good example of this. Its success is partly due to a simple system to capture data, which is easy to use, affordable harmonized across countries and offers a strong financial incentive for adopting it.

Many banks accept EDGE green building certification for their green financing instruments, sustainability linked financing, green bonds and green loans. The World Bank International Finance Corporation (IFC) is the biggest issuer of green bonds and loans and co-developed the green financing framework with the International Capital Markets Association (ICMA).

Standards can not only remove some of the risks of greenwashing; they also reduce the risk of 'greenhushing', as in sharing best practice organizations are also able to learn from each other's mistakes. But a plethora of different approaches is unhelpful for organizations already trying to keep pace with financial regulation and other initiatives.

As standards concerning sustainable finance and the carbon transition emerge, reducing complexity through harmonization and consolidation of existing standards will be key. Financial institutions need to be engaged throughout this process of alignment so that standard setters can understand organizational pain points and provide practical guidance for institutions and organizations on implementation, interoperability with other frameworks, as well as concrete examples of what good practice looks like.

Reducing standards complexity for coherence is an ongoing task. The industry already has good practice with product-based standards, of which EDGE is a clear case in point, and these examples help securitize assets, keep finance flowing and deepen the markets. For market-based standards, such as the ISSB standards, coherence and alignment are making progress, but interoperability is hindered as different jurisdictions do slightly different things in terms of market-based disclosure. Not only is it inefficient, it also carries legal risk for issuers.

Prudential regulation or standards for financial resilience and stability are currently most fragmented, as transition plans seem to be piecemeal and bottom-up. This prevents a challenge to get finance moving at this level, particularly for countries that are largely bank-based financed, where it's hard to deliver equity financing, for example.

Internationally accepted standards offer harmonization and clarity that can act as a 'safe harbour' in which to move towards sustainable and transitional finance. These standards must apply on both sides of the equation – to financial institutions, but also to their counterparts in the real economy which is supplying the data financial institutions need to create tools and products that will aid the transition.

Future standards, prospects and challenges in the coming years

The rigidity of existing regulations and frameworks are a challenge that organizations face while implementing transition plans. Reducing some of the existing complexity could be done with workable proxies. Well-established standards such as ISO standards on environmental management or health and safety management could act as a proxy for a ‘do no significant harm’ assessment, for example.

The balance in any standards framework, then, is to be struck between being specific enough to be usable, but broad enough to be flexible. Regulation and standards can be both enablers and barriers to the transition. To be enabling rather than obstructive requires transparency, harmonization where the right solution is found for each country’s context and environment, and then collaboration between the public and private sector on creating global systems that are coherent, consistent, and interoperable.

Standards need to also respect the principles of proportionality, practicability and clarity, focusing on what is truly necessary for each sector in order to free businesses, particularly small ones, from the burden of meeting standards. Making standards easily actionable is vital to a just transition, as is creating level playing fields through international alignment so that businesses do not have to fulfil three, four or more standards at one time.

Standards also have a role to play in defining and measuring impact. For financial institutions it should not just be about quantifying risk but also about generating a measurable impact. Standardizing impact measurement lies with standard setters such as ISO. While companies report on their activities, standards around defining and measuring impact could help to drive the transition, encouraging investors to consider how they could engage with businesses and organizations to transform.

Historically, science has not played the role it could have in the setting of standards, which has made applying standards challenging for certain industries, such as mining and construction. Radical change is needed to transform European economies if they are to meet their 2030 and 2050 goals, and not just in relation to the transition from oil and gas. For example, the steel used as standard for railways can now buckle due to the heat increasingly experienced in some countries. Applying science to standards will make them easier to use, helping to inform, for example, procurement guidelines for governments, or demand for low carbon concrete and low carbon steel that will allow industry to build resilience for the future, and to prosper without sacrificing ambition.

At the heart of all of this is harmonization. The goal CDP (formerly the Carbon Disclosure Project) is aiming for is that industry could in the future submit one report, which would apply in every jurisdiction and to every taxonomy. Consistency in the way in which data is presented as the basis of alignment for financial incentivization, so that, for example one tonne of CO2 equivalent, means the same, whatever the jurisdiction, regulation or standard. Identifying what the underlying principles are for each of the taxonomies to assure businesses they are disclosing transparently how they have interacted with them is also key to achieving this. Finally, there is the risk of a false dichotomy between flexibility and credibility, but standards bridge the two, offering both, allowing room for innovation while also having – and importantly, independently defining – impact.

The call to action

Standardization is high on the agenda for policymakers and organizations in the real economy and finance sector alike. Standardization for the sustainability transition and sustainable finance as an enabler is an essential tool for climate mitigation and adaptation. With harmonized global standard frameworks, common ground can be found, ranging from a mutual understanding of terminology to good operational practice and measuring the impacts of sustainable finance. The bridging of ISO standards with the likes of IFRS and the European ESRS standards through mutual agreements is a clear signal.

The mandate to harmonize standards lies with all stakeholders of standardization. The challenge now is to take existing standards, modify them in ways that will enable organizations to measure impact, and to streamline them, in collaboration with real world users of standards, so that transition to sustainable finance moves at the pace it needs to meet the climate challenges we face. Collaboration and coherence are critical for success and momentum and ISO is committed to enabling both by bringing global stakeholders together.

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