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Sustainable Finance Regulation International Agreements, Standards and Challenges

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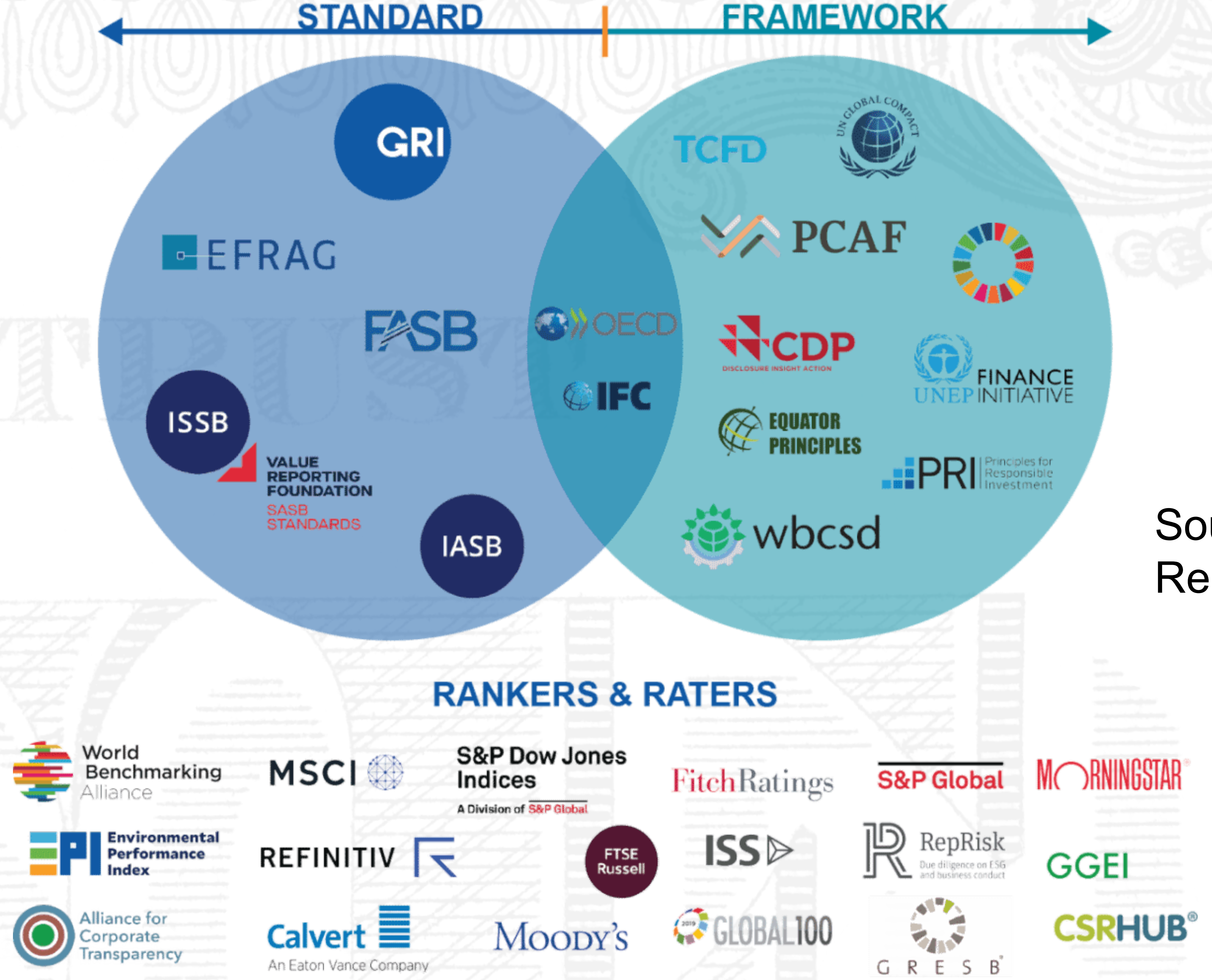

Source: Global Reporting Initiative.

The Paris Agreement

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COP Meetings

- The Conference of the Parties (COP) is the supreme decision-making body in relation to the UN Framework Convention on Climate Change.
- Its functions include:
  - **Review and implementation** of the Convention
  - **Decision making** – in relation to the effective implementation of the Convention
  - **National communications and emissions inventories** – assessment of effectiveness
  - **Negotiations and agreements** – additional agreements on actions
  - **Transparency and reporting** – members are required to report on actions, with those actions being reviewed by the COP
  - **Annual meetings** – exchange knowledge, share updates, and strengthen international cooperation

Timeline

1992	1995	1997	2001
Earth Summit Rio – UNFCCC opened for signature	COP1 - Berlin	Kyoto Protocol (reduction of greenhouse gas emissions)	Marrakesh rules implementing the Kyoto Protocol (funding etc)

2005	2007	2012	2013
Montreal – Kyoto protocol enters into force	COP13 – Bali roadmap for implementation beyond 2012	Doha – extends Kyoto protocol to 2020	COP19 – Warsaw adopts Green Climate Fund, International Framework for loss and damage, REDD+

2015	2021	2022	2024 (November)
COP21 Paris – Agreement reached on climate goals	COP26 Glasgow – rulebook for implementing Paris Agreement	COP28 Sharm el-Sheikh – establishes a loss and damage fund	COP29 - Baku

The Paris Agreement (COP 21)

- Climate Action
  - keep global temperatures well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5 degrees Celsius
- Nationally Determined Contributions
  - Countries submit national climate action plans (NDCs) which outline their efforts to reduce emissions and adapt to climate change
- Long-Term Strategies
  - formulate and submit long-term strategies to achieve low greenhouse gas emissions and climate resilience (not mandatory)
- Climate Finance
  - recognises the importance of finance and suggests ways it can be utilised
- Transparency and Accountability
  - transparency framework to track and report progress on climate action

The Paris Rulebook

- tools and processes to enable full, fair and effective implementation of the Paris Agreement.
- guidance on how countries should implement and strengthen their NDCs, whilst holding countries accountable for their commitments.
- how to track and mobilise finance to support developing countries.
- reporting on the efforts and progress towards the development and implementation of NDCs.
- take stock of collective progress towards long-term goals every 5 years.
- **Note:** the rulebook recognises that adequate and accessible finance is a pre-requisite for countries development of the technologies and capacity to fight climate change.

United Nations Sustainable Development Goals

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Sustainable Development Goals (SDG)

A series of 17 Goals adopted by the United Nations in 2015 as a universal call to action to end poverty, protect the planet, and ensure that by 2030 all people enjoy peace and prosperity.

- The SDGs are integrated
  - action in one area will affect outcomes in others
  - that development must balance social, economic, and environmental sustainability

- Challenges to the achievement of these goals:
  - Population growth and climate change
  - Inequalities
  - Economic and financial constraints
  - Technical and technological barriers
  - Cultural and behavioural Change
  - Lack of data and monitoring
  - Partnership and cooperation


SUSTAINABLE DEVELOPMENT GOALS
1 NO POVERTY
2 ZERO HUNGER
3 GOOD HEALTH AND WELL-BEING
4 QUALITY EDUCATION
5 GENDER EQUALITY
6 CLEAN WATER AND SANITATION
7 AFFORDABLE AND CLEAN ENERGY
8 DECENT WORK AND ECONOMIC GROWTH
9 INDUSTRY, INNOVATION AND INFRASTRUCTURE
10 REDUCED INEQUALITIES
11 SUSTAINABLE CITIES AND COMMUNITIES
12 RESPONSIBLE CONSUMPTION AND PRODUCTION
13 CLIMATE ACTION
14 LIFE BELOW WATER
15 LIFE ON LAND
16 PEACE, JUSTICE AND STRONG INSTITUTIONS
17 PARTNERSHIPS FOR THE GOALS

Impact on International Trade Agreements

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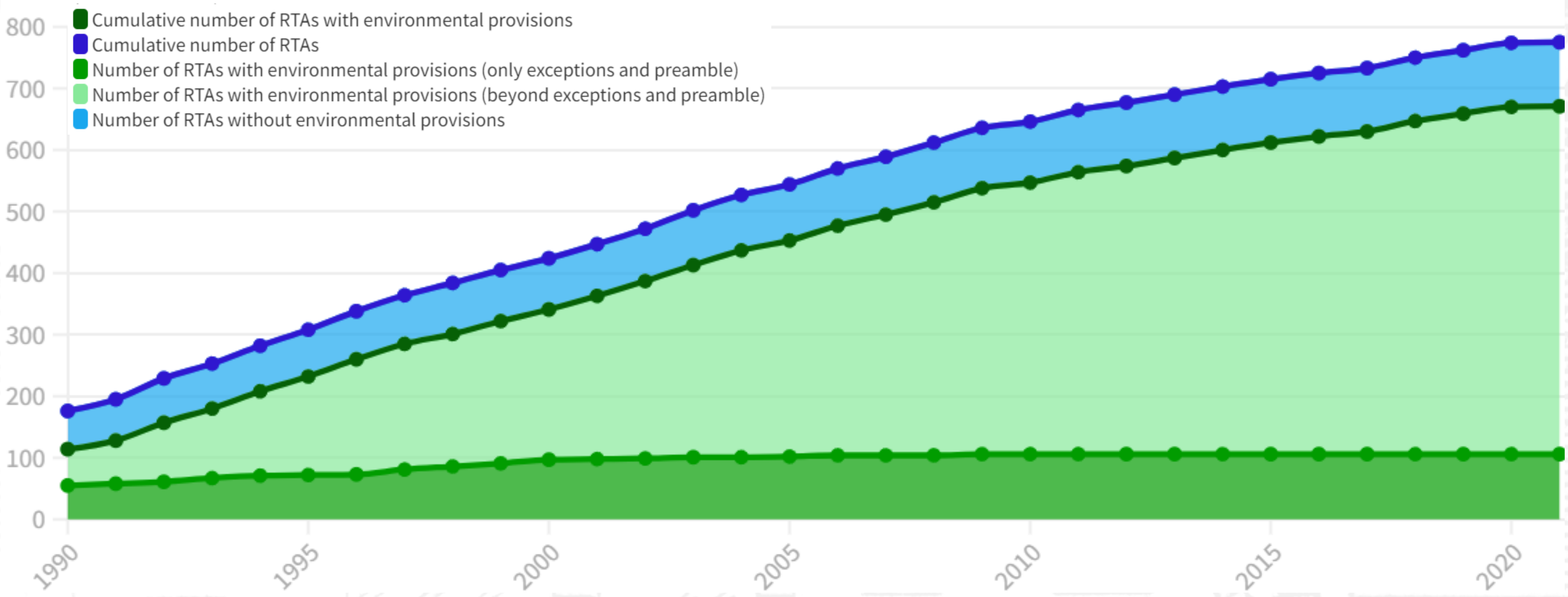
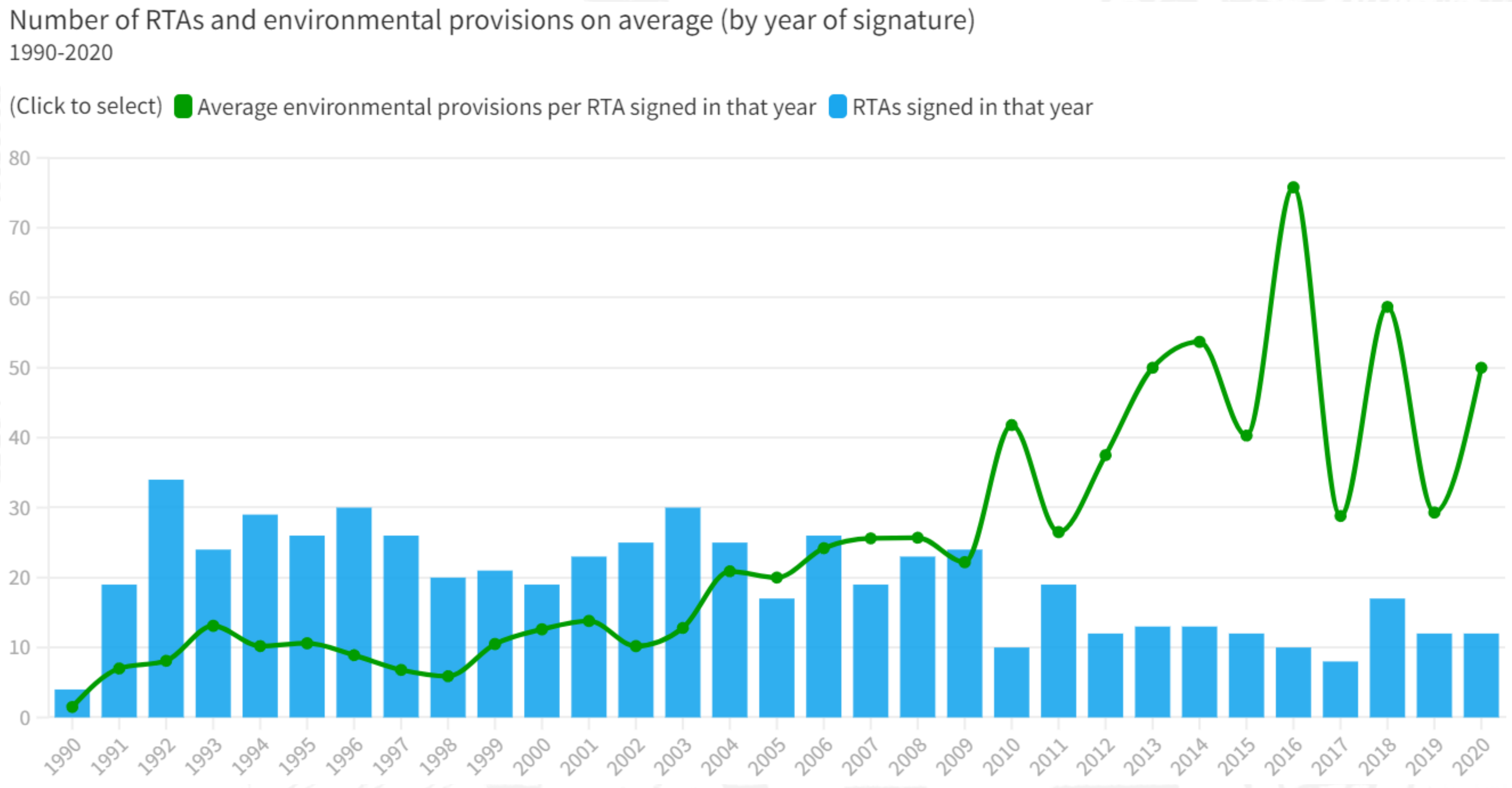
OECD Tracking of Environmental Provisions in Regional Trade Agreements

Cumulative number of RTAs with environmental provisions (by year of signature)
1990-2021



OECD Tracking of Environmental Provisions in Regional Trade Agreements



Principles for Responsible Investing

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Principles for Responsible Investment (PRI)

- UN-supported network of financial institutions cooperating on implementing the "Six Principles for Responsible Investing"
- Institutions acknowledge their duty to act in accordance with the principles as part of their fiduciary role in investing and financial services
- It is an *Institution-Led* initiative, although the process was initiated by the UN Secretary General.

PRI | Principles for Responsible Investment

The Principles

- **Principle 1:** We will incorporate ESG issues into investment analysis and decision-making processes.
- **Principle 2:** We will be active owners and incorporate ESG issues into our ownership policies and practices.
- **Principle 3:** We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- **Principle 4:** We will promote acceptance and implementation of the Principles within the investment industry.
- **Principle 5:** We will work together to enhance our effectiveness in implementing the Principles.
- **Principle 6:** We will each report on our activities and progress towards implementing the Principles.

A Quick Word on Professional Standards

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Professional Standards

- Can be described as the practices, skills, ethical behaviours and qualifications that have been established by a professional body to operate in a profession.
- Often divided between "Technical Standards" and "Ethical Standards".
- "Acting in the Public Interest"

"the net benefits derived for, and procedural rigor employed on behalf of, all society in relation to any action, decision or policy".

International Federation of Accountants

Why Standards?

- Emergence of “Stakeholder Capitalism”.
- Valuing all forms of “Capital”.
- Access to Relevant Information.
- Harmonisation.
- Transitions.

- Example:
  - **Double Materiality:** The concept of **double materiality** brings environmental impacts into the focus of standard-setting in accounting. This concept is **crucial for the fitness of the financial system** to facilitate a net-zero economy. Ultimately, it **simultaneously** provides for **financial materiality** and **sustainability materiality**

Täger, 2021

Setting Standards

- Identified need.
- Research and Stakeholder Consultations.
- Draft of standard.
- Public Review and Comment.
- Regulatory Impact Assessment.
- Finalisation and Publication.
- Ongoing Review and Revision.
- Ongoing Guidance and Interpretation.

International Sustainability Standards Board (IFRS S1 and S2)

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International Sustainability Standards Board

- The **International Sustainability Standards Board** (ISSB) under the IFRS Foundation has issued its two sustainability disclosure standards, **IFRS S1** and **IFRS S2**, marking a new era of sustainability-related disclosures in capital markets worldwide.
- IFRS Foundation has taken ownership of the resources developed by the Task Force on Climate-related Disclosures, including their four-pillar approach:
  - Governance.
  - Strategy.
  - Risk management.
  - Metrics and targets.

IFRS S1

- Guidance on what information companies need to disclose to investors about the **sustainability-related risks** and **opportunities** they face over the **short, medium, and long term**. It requires entities to disclose additional information if compliance with the specifically applicable requirements in IFRS Sustainability Disclosure Standards is insufficient to enable users of general-purpose financial reports to understand the effects of sustainability-related risks and opportunities on the entity's cash flows, its access to finance, and cost of capital over the short, medium, and long term.

(IFRS Foundation, 2023)

IFRS S2

- Specific climate-related disclosures and is designed to be used with IFRS S1:
  - the **governance processes**, **controls and procedures** the entity uses **to monitor, manage and oversee climate-related risks and opportunities**;
  - the entity's **strategy for managing climate-related risks and opportunities**;
  - the processes the entity uses **to identify, assess, prioritise and monitor climate-related risks and opportunities**
    - including whether and how those processes are integrated into and inform the entity's risk management process
  - the entity's **performance in relation to its climate-related risks and opportunities**, including progress towards any climate-related targets it has set, and any targets it is required to meet by law or regulation.

European Sustainability Reporting Standards

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European Sustainability Reporting Standards (ESRS)

- Developed by the European Financial Reporting Advisory Group and adopted by the European Commission on July 31, 2023.
- Compliance and disclosure requirements designed to make **corporate sustainability and environmental social governance (ESG) reporting more accurate, common, consistent, comparable, and standardised**.
- Key provision of the EU Corporate Sustainability Reporting Directive.
- They also include **respect for human rights**, a**nti-corruption and bribery**, and **diversity on company boards**.

European Sustainability Reporting Standards (ESRS)

- 12 'near final' European Sustainability Reporting Standards (ESRS) for public feedback.
- The first companies within the scope of CSRD will have to apply ESRS for periods beginning on or after January 1, 2024.
- Assess which topics to report using the double materiality concept, requiring information that is material from either a financial perspective or an impact perspective.
- Also reports on the value chain.

International Standards on Sustainability Assurance

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International Standards on Sustainability Assurance (ISSA)

- **ISSA 5000** - a proposed standard developed by the International Auditing and Assurance Standards Board.
- Designed **to enhance confidence in sustainability reporting** and responds to the recommendations of the International Organization of Securities Commissions (IOSCO).
- It complements the work of other standard setters, including the International Ethics Standards Board for Accountants, EFRAG, International Sustainability Standards Board, and IFRS Foundation.
- Applicable to both "**limited**" and "**reasonable**" assurance engagements.
- Aims to combat "**greenwashing**".

Global Reporting Initiative

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Global Reporting Initiative

- GRI Standards are intended to allow organisation to **report on their economy, environment and people**.
- Differentiates between “**Universal Standards**” and “**Sectoral Standards**”.
- Has developed **specialised standards** for between 45 and 50 “High-Impact” sectors

Other Standards and Standard Setting Bodies

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Other Standards and Standard Setting Bodies:

- **International Finance Corporation Performance Standards** (part of the World Bank)
- **AA 1000 Accountability Principles.**
- **Climate Disclosure Project (CDP)** - global disclosure system for investors, companies, cities, states and regions to manage environmental impacts.
- **Equator Principles** - a risk management framework for financial institutions to determine, assess and manage environmental and social risk in projects.
- **Climate Disclosure Standards Board.**

Other Standards and Standard Setting Bodies:

- United Nations Sustainable Stock Exchanges Initiative.
- ISO 26000.
- Sustainability Accounting Standards Board.
- Corporate Governance Development Framework.
- International Integrating Reporting Framework.
- ASEAN Sustainability Bond Standards.
- International Finance Corporation Corporate Governance Methodology.
- ISO 37000.

Other Standards and Standard Setting Bodies:

- Global Equity Sustainable Investment Practice Guidelines (Global Equity, 2023)
- Swiss Sustainable Investing Standards (Swiss Sustainable Finance, 2023)
- FNG Seal (Sustainable Investment Forum (FNG), 2023)
- LuxFlag (Luxumbourg Finance Labelling Agency, 2023)
- Nordic Swan Ecolabel (Nordic Swan Ecolabel, 2023)
- GreenFin Label (Government of the French Republic, 2023)

Problems with Voluntary Standards

- Voluntary compliance by way of audits and certifications **lack detail and do not have robust methodologies**.
- Organisations **not adhering to the standards that they have adopted**.
- The Standards **may not achieve the underlying goals** of those standards.
- Can be **extremely difficult for developing countries** to effectively implement.
- Different standards **may not agree on important definitions**, such as a definition of “sustainability”.
- The **scale of the challenge of changing** entire systems.

The Challenges in Regulating Sustainable Finance

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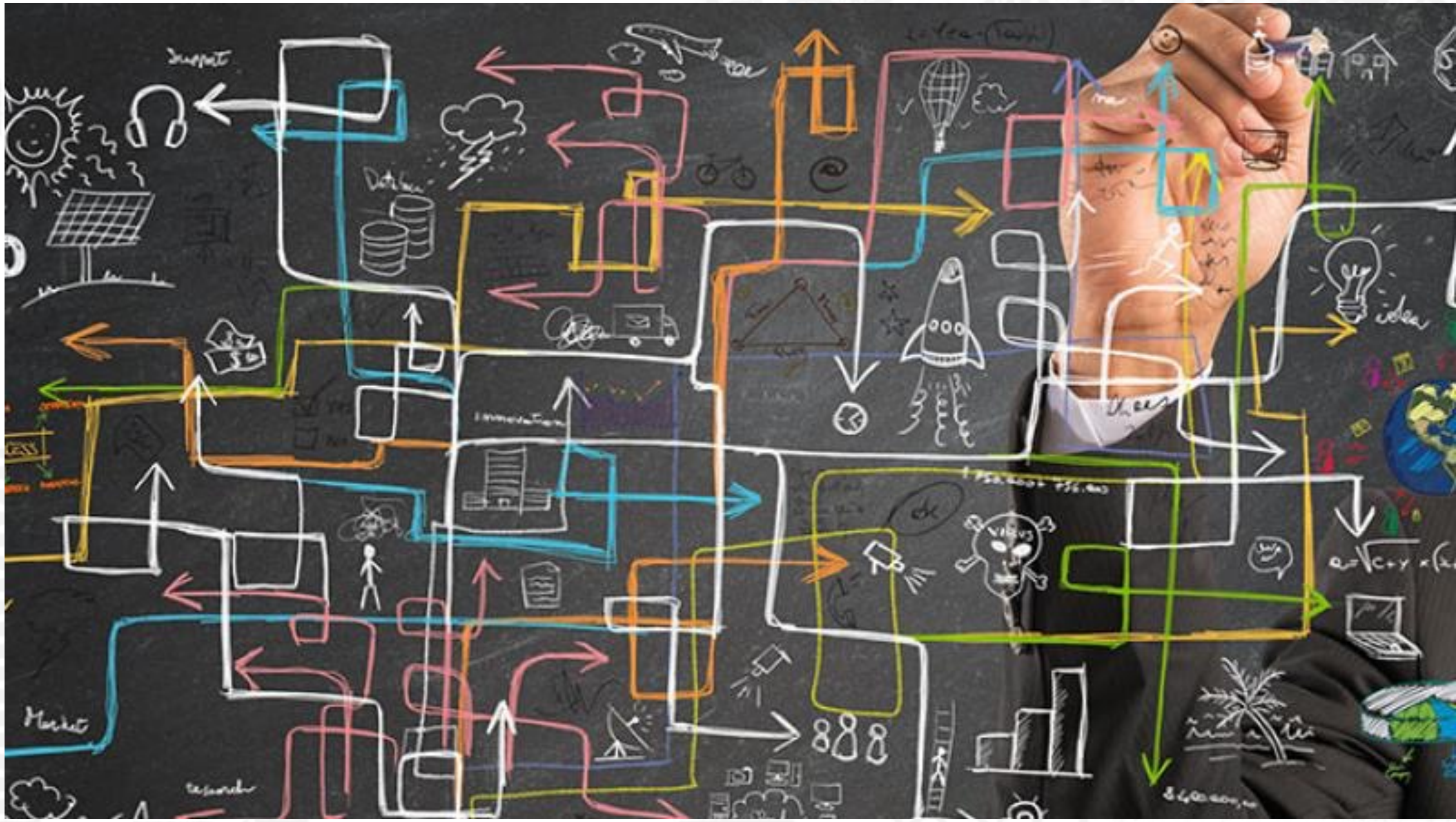
Lack of Standardisation

- There are a significant number of organisations, standards and regulations in the market.
- Many of these are competing for supremacy.
- Consistent and comparable standards are required for stakeholders to be able to effectively assess the performance of organisations in sustainable finance.

Complexity and Scope

- Covers a wide range of cross-discipline issues.
- Difficult to develop an all-encompassing and robust system that is effective in promoting the appropriate levels of transparency on green finance issues.



Greenwashing

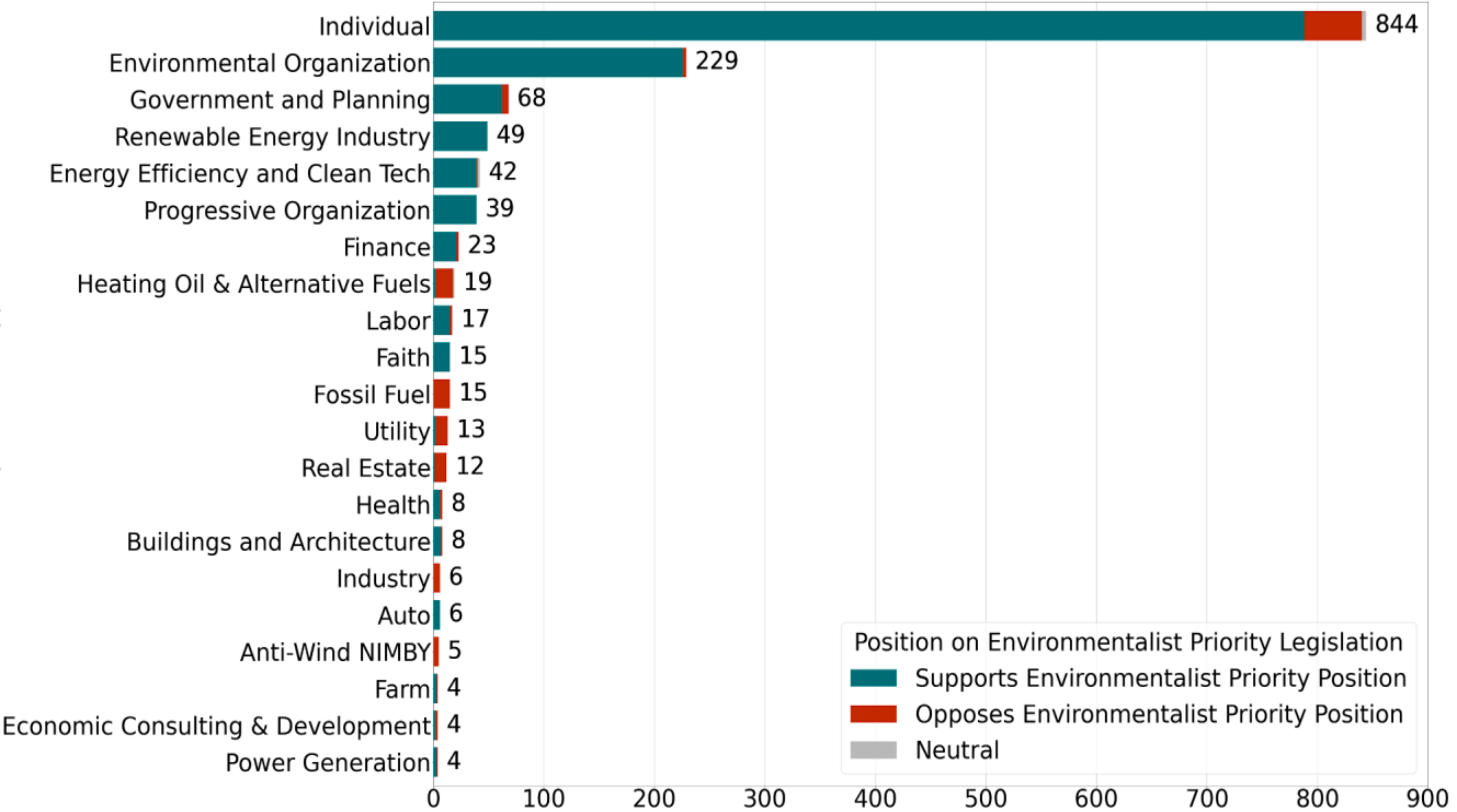
- The adoption of regulations and standards can have a number of **unintended consequences**, including firms attempting to “game” the system by **claiming a level of compliance with environmental standards that they do not have**.
- Examples of this identified by Earth.org include:
  - Oil producer BP changed their name to “Beyond Petroleum” and publicly added solar panels on their gas stations. A complaint has been lodged against BP for misleading the public by focusing on BP’s low-carbon energy products, when more than 96% of its annual spend is on oil and gas.
  - Starbucks introduced a “straw-less lid,” as part of its environmental policies. Unfortunately, the lid had more plastic than the previous lid and straw.

Availability of Expertise

- There are **very few professionals that span the range of expert knowledge required** to design appropriate regulations and standards or to assess compliance with those standards.
- Professionals from engineering, project management, sustainability consultants, accounting, financial services and a range of other persons are all operating as “experts” in the field, but it is questionable whether they have the necessary holistic overview of the topic to be considered truly expert in the field.

Pushback

- Some companies dispute the need for action against climate change.
- These companies are engaging **in active campaigns to dilute the impact of actions against climate change** (even when they appear to be making statements of support in public) (Culhane et al).
- Some of these companies are also involved in **providing funding for "grass-root" initiatives pushing back on climate action**.
- There are also aspects of certain **political ideologies and approaches to regulation** that oppose the actions on principle.



Individual
Environmental Organization
Government and Planning
Renewable Energy Industry
Energy Efficiency and Clean Tech
Progressive Organization
Finance
Heating Oil & Alternative Fuels
Labor
Faith
Fossil Fuel
Utility
Real Estate
Health
Buildings and Architecture
Industry
Auto
Anti-Wind NIMBY
Farm
Economic Consulting & Development
Power Generation
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Position on Environmentalist Priority Legislation
Supports Environmentalist Priority Position
Opposes Environmentalist Priority Position
Neutral