



2021 Synthesis Report

G20 Sustainable Finance Working Group

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Executive Summary

To meet the huge demand for investment that supports climate and sustainability goals, and to ensure that the financial system is resilient to climate-related risks, greater efforts and further international coordination are needed to scale up sustainable finance.¹

Improving international coordination on sustainable finance standards, practices, and related policies is critical to strengthen market integrity, further scale up sustainable finance flows, and facilitate cross-border green capital flows. Recognizing the need to coordinate on sustainable finance goals and priorities, as well as on the use of public policy incentives, **G20 members have re-established the Sustainable Finance Study Group and upgraded it to the G20 Sustainable Finance Working Group (SFWG), co-chaired by China and the United States, with Secretariat support provided by the United Nations Development Programme (UNDP).**

In 2021, the G20 Finance Ministers and Central Bank Governors asked the SFWG to develop a multi-year G20 Sustainable Finance Roadmap identifying the G20's sustainable finance priorities, and to carry out focused work on three specific priority areas: 1) Improving the comparability, and interoperability of approaches to align investments to sustainability goals; 2) Overcoming information challenges by improving sustainability reporting and disclosure; and 3) Enhancing the role of International Financial Institutions in supporting the goals of the Paris Agreement and 2030 Agenda.² Building on input papers from several international organizations and knowledge partners, as well as feedback collected during a series of consultations with stakeholders³, this report characterizes challenges, reviews existing practices, and proposes a set of recommendations to progress in these three areas. When country-level actions are discussed, they are to adopt on a voluntary basis. The outcomes of the 2021 SFWG work that are presented in this synthesis report have also contributed to shaping the multi-

¹ The OECD estimates that the Sustainable Development Goals (SDGs) financing gap in developing countries has widened by 70% to reach \$4.2 trillion (up from \$2.5 trillion) due to COVID. OECD (2020), Global Outlook on Financing for Sustainable Development 2021: A New Way to Invest for People and Planet, OECD Publishing, Paris, <https://doi.org/10.1787/e3c30a9a-en>

² Second G20 Finance Ministers and Central Bank Governors meeting Communiqué, 7 April 2021 <https://g20sfgw.org/wp-content/uploads/2021/08/2021-Communiqu%C2%AE-Second-G20-FMDBG-meeting-7-April.pdf>

³ Input papers and consultation briefs are available online: <https://g20sfgw.org/>



year G20 Sustainable Finance Roadmap developed by the SFWG in 2021. In the following years, under the relevant G20 Presidency, the SFWG will annually report progress against the agreed actions set out in the roadmap through the SFWG's report.

Improving comparability and interoperability of approaches to align investments to sustainability goals

Over the past few years, many countries, regions, and market actors, including G20 and non-G20 members, have recognized the role of private capital in supporting sustainability goals and have taken, or are planning to take, steps to scale up sustainable financial flows. One of the major efforts has been the development of approaches and tools (e.g., sustainability definitions, taxonomies, Environmental, Social and Governance (ESG) rating methodologies, verification and certification schemes, benchmarks and other portfolio or institutional alignment tools) to align financial investments with climate and other sustainability goals. These approaches and tools contribute to sustainable finance market development, including transition finance. However, if developed in silos and without due consideration of their interoperability, the proliferation of inconsistent approaches could generate market fragmentation, increase transaction costs (such as duplicating verifications, creating data inconsistencies, and leaving room for interpretations), and result in a higher risk of green and SDGs-washing. The synthesis report, drawing from input papers by the Bank for International Settlements (BIS), International Platform on Sustainable Finance (IPSF) and United Nations Department of Economic and Social Affairs (UN-DESA), Organisation for Economic Co-operation and Development (OECD), and The United Nations Environment Programme Finance Initiative (UNEP-FI), identifies several challenges in developing and improving the comparability and interoperability of approaches to align investments to sustainability goals (e.g., complexity and costs of navigating various approaches, inadequate flexibility for inclusion and applicability across jurisdictions with differing capacity levels, and low level of data availability and quality). The SFWG has developed high-level, voluntary principles for developing alignment approaches and recommendations for international coordination:



High-level principles for countries/markets that intend to develop their own approaches

1. Ensure material positive contributions to sustainability goals and focus on outcomes.
2. Avoid negative contribution to other sustainability goals (e.g., through do no significant harm to any sustainability goal requirements).
3. Be dynamic in adjustments reflecting changes in policies, technologies, and the state of the transition.
4. Reflect good governance and transparency.
5. Be science-based for environmental goals and science- or evidence-based for other sustainability issues.
6. Address transition considerations.

Recommendations for international coordination

1. Jurisdictions which intend to pursue a taxonomy-based approach to consider developing sustainable finance taxonomies using the same language (e.g., international standard industry classification and other internationally recognized classification systems), voluntary use of reference or common taxonomies, and regional collaboration on taxonomies.
2. Collaboration and active engagement of service providers, where consistent with applicable laws, with appropriate international organizations and financial authorities to enhance comparability, interoperability, and transparency of approaches, including forward-looking portfolio alignment tools, ESG rating methodologies, verification and labelling approaches.
3. Relevant international organizations, networks or initiatives to further advance work towards better understanding the technical aspects and interlinkages of existing and emerging alignment approaches, as well as good practices, and develop specific recommendations for enhanced comparability and interoperability.
4. Better integrate transition finance considerations into sustainable finance alignment approaches, with a focus on interoperability with existing and emerging approaches for sustainable finance, based on the mapping and review of existing and emerging approaches by the SFWG and appropriate international organizations.

Overcoming information challenges by improving sustainability reporting and disclosure

Sustainability reporting and disclosure has become more widespread internationally since its beginnings in the 1990s, yet it has been widely observed that sustainability-related reporting remains incomplete and inconsistent across companies and jurisdictions. As a result, investors may not be able to receive the sustainability-related information they need to make informed investment decisions -including to evaluate low greenhouse gas emission development strategies- and, as noted by many participants in the SFWG engagement activities with the private sector and international organizations, the market may misprice financial assets. This could harm market integrity and undermine markets'



ability to support the proper allocation of capital towards sustainability goals. In addition to the lack of consistency, there are a number of other challenges in the extent and quality of sustainability reporting by firms (such as incomplete coverage of the Sustainable Development Goals (SDGs) related issues in reporting frameworks, lack of capacity for Small and Medium-sized Enterprises (SMEs) in implementing reporting requirements, etc.). After consultation with the International Organization of Securities Commissions (IOSCO), the International Financial Reporting Standards (IFRS) Foundation and other relevant stakeholders, the SFWG has developed the following recommendations:

Recommendations on overcoming information challenges by improving sustainability reporting and disclosure

1. G20 to welcome the work program of the International Financial Reporting Standards (IFRS) Foundation.
2. The International Sustainability Standards Board (ISSB) should develop a baseline global sustainability reporting standard while allowing flexibility for interoperability with national and regional requirements.
3. Start from climate and extend to other sustainability factors over time. The ISSB should take a 'climate first' approach in the near term, based on the Taskforce on Climate-related Financial Disclosures (TCFD) framework, in developing the reporting standards. However, the ISSB should develop standards covering other sustainability topics, which could include nature, biodiversity, and social issues.
4. Enhance efforts on capacity building for SMEs and emerging markets. While the standards to be developed by the ISSB may be adopted by a broad range of jurisdictions around the world as a global baseline for reporting, SMEs and emerging markets could benefit from additional capacity-building initiatives.

Enhancing the Role of International Financial Institutions in supporting the goals of the Paris Agreement and 2030 Agenda

International Financial Institutions (IFIs), including Multilateral Development Banks (MDBs), play a critical role in supporting the goals of the Paris Agreement and 2030 Agenda: providing stable, long-term, and counter-cyclical lending at affordable rates and supporting climate action, such as the implementation of transition and low greenhouse gas emission development strategies, through the development of new financing instruments or frameworks. These instruments expand the pool of resources available for climate mitigation and adaptation efforts in accordance with countries Nationally Determined Contributions (NDC) and help catalyse investment from the private sector. While MDBs have made good progress, there remains a significant gap between the



scope of their climate work programs and the scale and speed required to achieve the goals of the Paris Agreement and 2030 Agenda. There are increasingly strong calls from political leaders and experts for the MDBs to scale up and accelerate their ongoing work in this area, for example, enhancing the climate-related financing commitments, the engagement with governments in emerging markets and developing countries to increase the supply of bankable green projects, and the support for quality NDCs through financing and capacity assistance. After consultation with relevant stakeholders, the SFWG developed the following recommendations:

Recommendations on enhancing the Role of International Financial Institutions in supporting the goals of the Paris Agreement and 2030 Agenda

MDBs should:

1. Raise ambition in financing climate actions. MDBs should work with clients to ensure that adaptation and resilience are embedded in investments and policies. Adaptation finance should be prioritized in country contexts where urgent adaptation to climate change is required.
2. Scale-up de-risking facilities for crowding in private sector finance. MDBs are encouraged to use financial and non-financial tools to help governments and the private sector overcome real and perceived risks and other barriers to climate investment.
3. Step up efforts to support developing countries in developing policy frameworks for sustainable finance. MDBs, working with others, can play a critical role in disseminating knowledge, building technical capacity, helping develop the policy and regulatory frameworks such as taxonomies and disclosure requirements, assisting in product innovation by local financial institutions, and nature-based solutions or ecosystem-based approaches.
4. Enhance engagement with countries on ambitious NDCs and long-term low greenhouse gas emission development strategies (LTS) development and implementation. MDBs need to coordinate their in-country support, which is key to effective LTS development to maximize the impact of MDB on the Paris Alignment at the country level. MDBs, in partnership with others working on NDCs, could support countries in developing tools and innovations to improve the NDC ecosystems, and target translating NDCs into bankable projects able to attract private international and domestic finance.
5. Devote resources to the climate transition. MDBs could play a key role in helping emerging markets and developing economies in establishing a framework for financing the climate transition and mitigating the negative social impact of transition by helping the sectors and segments of the population particularly vulnerable in coping with the transition. Targeted actions would include technical pathways, green capital markets development, disclosure requirements, de-risking facilities, and financing products - by initiating pilot projects in key sectors such as energy, transportation, and heavy manufacturing.



Introduction

On April 7th, 2021, under Italy's G20 Presidency, Finance Ministers and Central Bank Governors agreed to re-establish the Sustainable Finance Study Group (SFSG) and upgrade it to the "G20 Sustainable Finance Working Group" (SFWG).⁴ Its agenda was anchored in the three G20 priorities: People, Planet and Prosperity.

Meeting the collective goals under the Paris Agreement and the 2030 Agenda will require an economy-wide transition, supported by significant financial flows. This transition has begun, and financial markets are starting to play their role. Sustainable debt issuance is on track to surpass a record \$1 trillion in 2021 as global sustainable debt issuance exceeded \$680bn in H1 2021, more than twice the level of H1 2020—and is already close to the \$700bn mark reached for the full year 2020.⁵ This rapid rise of the sustainability bonds market shows that there is a real interest from market participants for investments with sustainability benefits.⁶ However, while the share of financial assets contributing to sustainability has increased over the past years, it still represents less than 5% of global financial assets.⁷ Scaling up sustainable finance – including aligning financial flows to the Sustainable Development Goals (SDGs) and the Paris Agreement targets and mobilizing resources to where it is most needed – still represents a challenge with new and more complex barriers emerging as the practice evolves. The OECD estimates that the SDG financing gap in developing countries has widened by 70% to reach \$4.2 trillion (up from \$2.5 trillion) due to COVID.⁸

⁴ Launched in 2016 during China's G20 presidency, the Green Finance Study Group was mandated to identify institutional and market barriers to green finance and develop options on how to enhance the ability of the financial system to mobilize private capital for green investments. In 2018, under the Argentinian Presidency, its remit was expanded to consider additional aspects of sustainable development and the group was renamed Sustainable Finance Study Group (SFSG).

⁵ https://www.iif.com/Portals/0/Files/content/SDM_July2021_vf.pdf

⁶ "Sustainable debt hit a new record in 2020 for greatest volume of issuance in a year, at \$732.1 billion across bond and loan varieties raised with environmental and social purposes in mind (...) This represents a 29% increase on 2019". Source: Bloomberg. <https://about.bnef.com/blog/sustainable-debt-breaks-annual-record-despite-covid-19-challenges/>

⁷ Sustainable debt issuance is projected to top \$1tn in 2021, which will bring the market size to well above \$3tn, according to the IIF. The global assets under management (AUM) for 2020 are estimated by PwC to be \$111.2tn.

⁸ Source: SDG Financing: Key findings from the OECD Global Outlook on Financing for Sustainable Development 2021 Presentation by Jorge Moreira da Silva, November 2020



While the rapid increase in the number of domestic, regional, and global initiatives signals a growing interest in alignment tools supporting sustainability goals, it has created a fragmented landscape.⁹ If not appropriately coordinated, this may hinder progress in mobilizing private sector financing for the global climate agenda and the SDGs, in part due to inconsistent rules and communication approaches. Ensuring the credibility of sustainable investment products and strategies is critical to build market integrity and keep market momentum. The COVID-19 crisis has also highlighted the urgent need to improve the stability and efficiency of the financial markets by adequately addressing sustainability risks, including climate, environment, biodiversity and social-related ones. Similarly, there is an urgent need to assess the impact of public finance and policies that could influence sustainable investment decisions, in order to avoid fragmented initiatives that might hamper or reduce the effectiveness of such efforts.

In 2021, the G20 Finance Ministers and Central Bank Governors have mandated the SFWG to develop, in a collaborative manner, an initial evidence-based and climate-focused G20 sustainable finance roadmap and to work on three priority areas for 2021, taking into consideration their relevance, urgency and need for global coordination, and the ongoing international work from International Financial Institutions, international organizations, and financial stability and regulatory networks as well as individual jurisdictions:¹⁰

- 1) Improving comparability and interoperability of approaches to align investments to sustainability goals
- 2) Overcoming information challenges by improving sustainability reporting and disclosure
- 3) Enhancing the role of International Financial Institutions in supporting the goals of the Paris Agreement and 2030 Agenda

This report synthesises the deep analysis conducted by the SFWG and puts forward a set of recommendations to progress in these three areas. When country-level actions are discussed, they are to adopt on a voluntary basis. The report has been informed by input

⁹ GISD (2020). Renewed, recharged and reinforced. Urgent actions to harmonize and scale sustainable finance. OECD, UNDP (2020). Framework for SDG Aligned Finance <https://sdgfinance.undp.org/sites/default/files/Framework%20for%20SDG%20Aligned%20Finance%20OECD%20UNDP.pdf> IIF (2020). Sustainable Finance Policy & Regulation: The Case for Greater International Alignment NGFS (2020). Sustainable Finance Market Dynamics Report

¹⁰ <https://www.g20.org/wp-content/uploads/2021/04/Communique-Second-G20-Finance-Ministers-and-Central-Bank-Governors-Meeting-7-April-2021.pdf>



papers from several international organizations¹¹ leading on each of these topics. The process also benefits from feedback collected during a series of consultations with different stakeholders including a sustainable finance roundtable, and three workshops with international organizations, private sector organizations, and G20 engagement groups. Those consultations opened a conversation around the structure of the roadmap and helped the SFWG to advance a stock-take of different activities and solutions related to the roadmap focus areas to accelerate the mobilization of public and private capital towards the achievement of the goals of the Paris Agreement and the 2030 Agenda.

The outcomes of the 2021 SFWG work that are presented in this synthesis report have also contributed to shaping the multi-year G20 Sustainable Finance Roadmap developed by the SFWG in 2021. In the following years, under the relevant G20 Presidency, the SFWG will annually report progress against the actions set out in the roadmap through the SFWG's report.

¹¹ The following entities have submitted input papers to the SFWG: BIS, FC4S, ICC, IFRS and GSG, IOSCO, IPSF and UN-DESA, NGFS, ADB-World Bank Group, OECD on behalf of the Joint MDB Group, UNEP-FI and UNDP. Input papers are prepared by the authoring institutions as a contribution to the SFWG but have not been endorsed by it nor do they represent the official views or position of the Group or any of its members.



Improving comparability and interoperability of approaches to align investments to sustainability goals

1.1. Background

Over the past few years, many countries and regions, including G20 and non-G20 members, have recognized the role of private capital in supporting sustainability goals and have taken or are planning to take steps to scale up sustainable financial flows. One of the major efforts in these steps has been the development of approaches and tools to align financial investments with sustainability goals.¹² These approaches include, among others, sustainability definitions and taxonomies, ESG ratings, verification and certification schemes, as well as portfolio alignment tools. Some countries and /or regions are taking a public-driven, top-down approach, such as the Chinese and the European Union (EU) approaches grounded in activity-level taxonomies,¹³ while some others are relying on more principles-based approaches and/or taking a bottom-up approach by encouraging the use of market-led solutions, such as adopting or adapting the International Capital Market Association’s (ICMA) Green Bond Principles or Financing Climate Transition Guidelines and building on private-led principles to construct sustainable investment portfolios (e.g., Global Investors for Sustainable Development Alliance (GISD) Sustainable Investing Definition).

Given that “alignment” of investments to sustainability goals can entail identification, verification, aggregation of a collection of investments or products, and in some cases, setting targets and reporting on performance, for simplicity we use the word “alignment” to describe all these approaches in most of the following discussion. For illustrative purposes, we list some of these approaches in Table 1 and present some of their usages in aligning economic activities, financial assets and portfolios with sustainability goals.

¹² IPSF and UN-DESA, improving compatibility of approaches to identify, verify and align investments to sustainability goals, as an input paper to this report, 2021

¹³ On the July, 6th 2021 the European Commission has proposed a Regulation on a voluntary European Green Bond Standard (EU-GBS). This proposal will create a high-quality voluntary standard available to all issuers (private and sovereigns) to help financing sustainable investments. The proposal envisages the EU-GBS alignment with the EU taxonomy.



Table 1: Usage and examples of approaches to aligning investments to sustainability goals¹⁴

Level	Examples of some approaches	Intended usage
Activity or underlying asset	Taxonomies, definitions	Providing boundary and classification of qualified assets and/or activities
Financial instrument	ESG ratings, labels, certification/verification	Identification of specific investments as sustainable
Portfolio level	Indices, benchmarks, alignment metrics, portfolio tools	Impact and/or performance measurement on the aggregate level

These alignment approaches, if properly designed and used, can enhance the credibility of sustainable investments, which is critical to build market integrity and keep market momentum. In some cases, they can also identify, guide, and orient investments. The rapid rise of the sustainable finance market in the past years shows that there is a real interest from market participants for investments with environmental and/or social benefits. More individual investors are also expressing interest in sustainable investing practices (from 71% in 2015 to 85% in 2019, in one survey).¹⁵ Standards, ratings, verification schemes and other alignment approaches and related metrics are key to ensure that sustainable investments and underlying assets and activities do not mislead investors and achieve intended impacts (Table 1).

However, there has been a multiplication of approaches to align investments with sustainability goals over the past few years. While these approaches provide useful tools, if developed in silos and without consideration of interoperability, they could generate market fragmentation, increase transaction costs, create data inconsistencies and leave room for interpretations, and result in a higher risk of greenwashing and, more broadly, SDGs-washing practices, thus hindering the efforts to align financial flows with sustainability goals. For example, 72% of 5,300 wealthy investors surveyed found sustainable investing terms confusing.¹⁶ In another survey of institutional investors, about 50% of participants indicated that the lack of agreement around terms and definitions continues to stifle responsible investment efforts.¹⁷

¹⁴ Note that some of these approaches are used both for identifying sustainability and to reflect a simple-high level assessment of whether firms are more or less resilient to sustainability risks.

¹⁵ Morgan Stanley, “Sustainable Signals: Individual Investor Interest Driven by Impact, Conviction and Choice” (2019).

¹⁶ UBS, “Global insights: What’s on investors’ minds: Return on values” (2018, Volume 2).

¹⁷ AON, “Global perspectives on responsible investing” (2018).



This chapter reviews some of the existing and emerging approaches to sustainable finance alignment and identifies some of the main challenges in the development and use of these approaches. It also reviews existing practices and explores ways to improve their comparability, interoperability, and as appropriate their consistency, while acknowledging the need to accommodate local specificities and recalling that increased global alignment does not imply a “one size fits all” solution. Based on a stock-taking analysis, followed by a discussion of challenges and key issues, the report provides a set of principles and high-level recommendations for the future development of alignment approaches and global coordination.

1.2. Stocktaking of existing and emerging approaches

This section provides more details on a sampling of existing alignment approaches from the public and private sectors. The section includes information on taxonomies, ESG ratings and investment approaches, and verification/certification schemes, and discusses the use of tools such as labelling, investment fund benchmarks, strategies and targets in ESG product development. It is not meant to be exhaustive due to the broad and growing number of alignment approaches (see Figure 1).

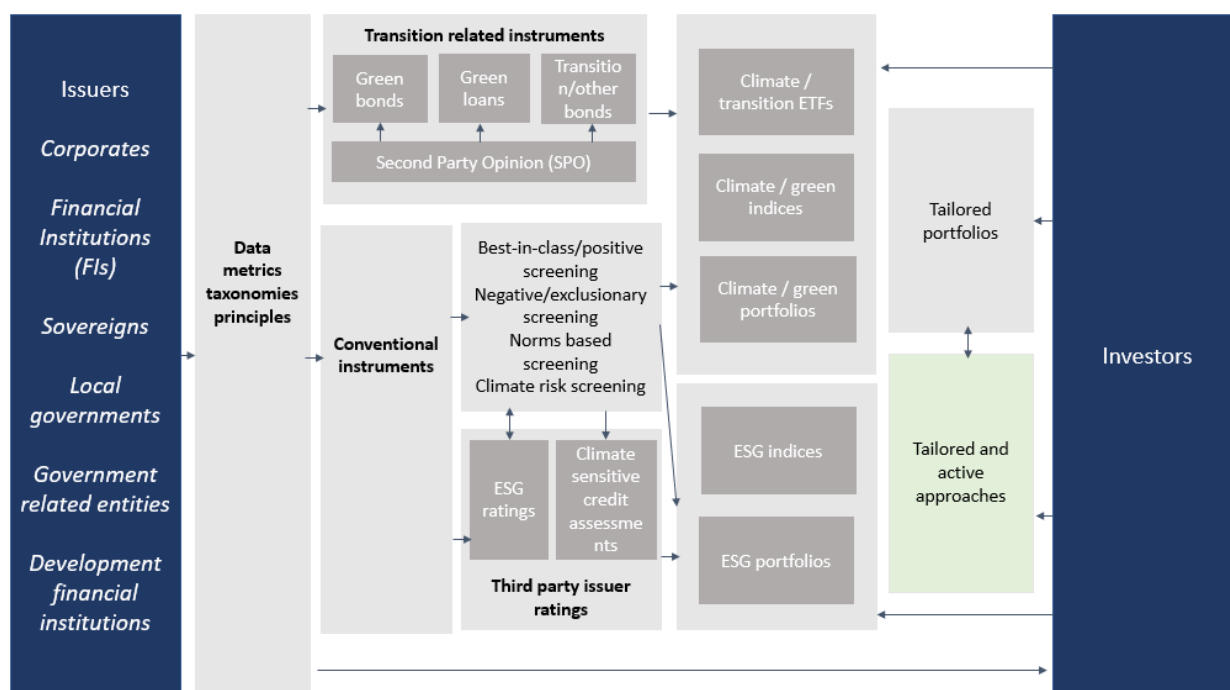
To the extent that the various tools for identifying sustainable investments support market growth, further development of tailored climate and other sustainability-related financial products, and practices to realign capital with low greenhouse gas emission economies can help support emissions reduction and climate adaptation. Such tailored sustainability-relevant products encompass instruments for issuers, third party ratings, as well as index and portfolio products to help channel available capital. If fit for purpose, these products have the potential to improve information flow, price discovery, market efficiency and liquidity in support of a low greenhouse gas transition.¹⁸

Developed in some cases on the basis of various alignment approaches, products and instruments, such as those outlined in Figure 1, have grown rapidly from relatively early stages of development. While increased demand for products and instruments that support sustainability goals is promising, more efforts are needed to ensure that the alignment of the financial products to these goals is truly credible.

¹⁸ OECD (2021), Financial Markets and Climate Transition, OECD Publishing, Paris, forthcoming.



Figure 1: Growing number of sustainable investment financial market products and practices are emerging



Note: non-exhaustive illustration

Source: adapted from OECD (2021), Financial Markets and Climate Transition, OECD Publishing, Paris, forthcoming

There is a range of terminologies used to describe some of the existing approaches for aligning investments with sustainability goals, including, among others, definitions, taxonomies, ESG ratings, verification and certification schemes, product alignment approaches and strategies and targets. In this document we use the following terminologies:

- 1) **Definitions:** Sustainable finance definitions as used in this document, refer to clarification of the boundary of activities and/or assets that are consistent with sustainability goals. Such definitions are typically developed using high-level principles such as “positive contributions to SDGs” (e.g., greenhouse gas mitigation and adaptation, or goals including environmental protection, climate action, and promotion of circular economies) and “no significant harm to any other SDGs”.
- 2) **Taxonomies:** Sustainable finance taxonomies typically refer to documents that include a boundary (definition) and provide categorization of specific sustainable



investment or economic activities within the boundary. Sustainable finance taxonomies can be used by financial institutions to identify activities, assets or revenue segments that support climate and sustainability goals. In recent years, some organizations have also begun to develop taxonomies of “unsustainable activities” covering activities with negative environmental and climate impact, such as those considered carbon-intensive and polluting.

- 3) **ESG rating methodologies:** Methodologies used to provide quantitative ratings based on environmental, social and governance (ESG) performance of financial assets (e.g., stocks and bonds), companies, and/or projects. Some ESG ratings actually reflect resilience against sustainability risks, while others focus on sustainable impacts. ESG ratings are provided by data providers, including several global credit rating agencies. Also, many financial intermediaries develop their own internal ESG ratings systems.
- 4) **Verifications, certifications, second opinions and third-party reviews:** Opinions provided by third parties on whether companies, projects, and investment products (assets) and their activities deliver environmental and social benefits or harm and, in some cases, with quantification of these impacts. The deliverables of these services often take the form of labelling (e.g., labelling a bond as green or sustainable). Some jurisdictions and market-led organizations have established voluntary standards and certification that specify criteria financial instruments or products must meet to receive a particular sustainability label (e.g., EU Green bond standard, Climate Bonds Standard).
- 5) **Alignment approaches at portfolio levels:** Market benchmarks, portfolio alignment metrics, and sustainable investment strategies (such as white list, blacklist, ESG integration, theme-based investing, and index investing) are also used to align investment activities and products with sustainability goals.
- 6) **Strategies and targets at the institutional level:** various institutions have made commitments to align their strategies with the 2030 Agenda and the Paris Agreement or other sustainability-related goals. There are various initiatives that support these commitments, including schemes that help firms establish strategies and interim targets to reach their targets.

In the following, we take stock of some of the frequently used alignment approaches in different markets, noting that it is not exhaustive due to the broad and diverse scope of approaches.



1.2.1. Taxonomies

Sustainable finance taxonomies define the technical boundary for and provide a classification of economic activities, including technical characteristics, that can be considered sustainable and supported by sustainable finance. Once there is a shared understanding of what is meant by sustainable activities, investors are able to operationalize it and develop investment products and strategies that comply with it.

Taxonomies support market development by providing clarity as to what assets, activities or revenue segments are aligned with sustainability goals. As such, they can be a useful tool in the implementation of low-greenhouse gas transitions strategies. They should, as far as possible, be science-based rather than on opinions. Such clarity can help to prevent green- or SDG-washing, thereby contributing to market integrity. Taxonomies are often referenced in other alignment tools such as verifications and ESG ratings and can provide a basis for measurement of progress or performance of financial institutions and products in supporting SDG-aligned investments. In some jurisdictions, taxonomies are also used by governments to provide targeted incentives such as low-cost funding, interest subsidies, and guarantees to sustainable projects.

Different markets have adopted different approaches in developing their taxonomies, including those developed through a top-down approach, such as the China and EU taxonomies, where the government or government-led agencies are taking the lead in the development and application process, or a bottom-up approach, such as the Climate Bonds Standards on the basis of Green Bond Principles, where the private sector is playing a key role in forging consensus of what shall be considered sustainable and organizing the implementation process. More than 20 countries and economies have already developed or are working to develop a taxonomy.¹⁹ Many financial institutions, such as the Fourth Swedish National Pension Fund (AP4), Pacific Investment Management Company (PIMCO), Banque Nationale de Paris Paribas (BNPP), Deutsche Bank and Natixis, have also developed their own taxonomies for internal use.

Most taxonomies include climate-related objectives while some have extended their coverage to include other sustainability objectives, including pollution control, biodiversity and circular economy. A few taxonomies have also incorporated social elements. One example is the Mongolia Taxonomy which includes “livelihood development” as a core objective. Another example is the EU Taxonomy, which includes “minimum social safeguards” with reference to international principles and conventions

¹⁹ IPSF and UNDESA, Improving compatibility of approaches to identify, verify and align investments to sustainability goals, as an input paper to this report, 2021



and is planning an extension to social objectives.²⁰ Transparency with regards to existing taxonomies is generally good with detailed information available publicly²¹.

Government-driven approach

The Government-driven or top-down approach has been adopted by some countries/regions to develop taxonomies and they are implemented in a mandatory way. These include taxonomies developed by China and the EU with a “whitelist” and/or a technical screening criterion (TSC).

- **The China taxonomy** presents a detailed list of eligible economic activities and projects under various sectors and subsectors. Although not “technology-neutral”, it provides an explicit list of eligible technologies and sets key technical criteria by directly using the national and/or international standards. This implies that activities can be eligible only if the activity has been included in the list and comply with the applicable standards. The starting point is that green transition is technology-driven, and some innovative technological solutions could be applied to multiple economic sectors to reduce environmental pollution and greenhouse gas (GHG) emissions and enable a circular economy. This method can be used to include technical solutions easily, hence adapt to the dynamic nature of green transition and sustainable development.
- **The EU taxonomy** defines eligibility using a TSC approach for which specific screening criteria must be met for an activity to be included. The technical screening criteria frame both when an activity is considered to make a substantial contribution to at least one of the six environmental objectives²² and do no significant harm (DNSH) to the other environmental objectives. Within the sectors it covers, it sets out to be technology-neutral in that activities can be deemed sustainable if they meet the TSC. This approach covers a broader section of the economy, as TSC is set across both obviously green and non-green industries, but where the latter makes a substantial contribution to EU environmental objectives through their enabling potential or transitional character.

²⁰ Call for feedback on the draft reports by the Platform on Sustainable Finance on a social taxonomy, European Commission, DG FISMA, 12 July 2021, https://ec.europa.eu/info/publications/210712-sustainable-finance-platform-draft-reports_en

²¹ The International Platform on Sustainable Finance (IPSF) has provided a stock-take and analysis of emerging taxonomies in its annual report of October 2020 and the referenced input paper for the G20 SFWG.

²² The six objectives defined in the EU Taxonomy regulation are: climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources; transition to a circular economy; pollution prevention and control; and protection and restoration of biodiversity and ecosystems



The China and EU taxonomies are being used by some other markets as a starting point for the development of their national taxonomies. Taxonomy developments in other countries thus far are already leveraging the existing taxonomies available and have largely followed either of these or a “simpler & blend” of these approaches. For example, the South Africa Taxonomy largely follows the EU approach while accounting for local differences and laws, while the Russian and Mongolian taxonomies are similar in approach to the China Taxonomy with differences in the level of detail and coverage.

Box 1: The International Platform on Sustainable Finance

The International Platform on Sustainable Finance (IPSF) was launched in October 2019 with the aim of opening a channel of dialogue and exchange between international policymakers in the field of sustainable finance, initially focused on taxonomy-based approaches to sustainable financial market development. Today, the IPSF counts 17 member jurisdictions and 11 observers representing 55% of global GHG emissions, thereby gathering a critical mass of knowledge and expertise to make progress towards more integrated approaches for the development of sustainable finance frameworks worldwide.

The IPSF works to coordinate approaches and develop coherent sustainable finance frameworks/tools, in particular in areas that enable investors to identify green investment opportunities across the globe. It is anticipated that this will ultimately reduce transaction costs and help smooth the path to more cross-border capital flows into green projects. The international platform focuses particularly on initiatives in the area of taxonomies, disclosures, standards and labels, which are fundamental for investors to identify and seize the investment opportunities worldwide that contribute to climate and environmental objectives.

IPSF members are committed to exchanging and disseminating information to promote best practices, comparing their different initiatives and identifying barriers and opportunities to enhance environmentally sustainable finance globally while respecting their respective national and regional contexts. Where appropriate, willing members can further strive to align their initiatives and approaches.

Market-Driven Approach

There are also some market-led or bottom-up approaches to taxonomies that are recognized or used in many markets or institutions. Incorporation of or referencing to taxonomies and principles developed by the market (i.e., Climate Bond Initiative’s (CBI) Climate Bond Standards and ICMA’s Green Bond Principles) into the national or regional framework is common. For example, the Green Bond Standards developed by the Association of Southeast Asian Nations (ASEAN) Capital Market Forum (ACMF) in October 2018 and the ICMA’s Green Bond Guidelines developed by the Japanese Ministry of Environment in 2017 were based on the Green Bond Principles (GBP) framework. ASEAN finance ministers and central bank governors announced in March



2021 their support for an ASEAN Taxonomy of Sustainable Finance²³, which would serve as ASEAN's common language for sustainable finance and account for both international goals and ASEAN's specific needs. Other countries do not see a need for national-level taxonomies and believe that they can defer to the market to provide alignment approaches while focusing public-sector efforts on risk, disclosures, and investor protection.

1.2.2. ESG ratings and investing approaches

ESG ratings and investment approaches represent an increasingly important tool for integrating sustainability considerations into investment processes, and in concept could serve to support investors in making informed decisions and value judgments about asset allocation. If fit for purpose, ESG ratings could help financial investors who seek to evaluate the conditions, practices and strategies related to environmental, social and governance risks and issues over the medium term. In addition, they could also support risk management to reduce the impact of climate change and other sustainability risks on corporate performance and navigate a transition to low-greenhouse gas and circular economy strategies which could bring new growth opportunities over time.

Assets under management of institutional investors that state they have employed ESG investing approaches have risen to almost USD 40 trillion.²⁴ ESG ratings are now applied to companies representing 80% of market capitalisation in 2020.²⁵

There is a growing number of ESG rating methodologies, which are quite different in their design or main use. The key elements of a typical rating methodology include:

- **the selection of indicators** (some use as many as over 100 indicators covering environment, social and governance issues),
- **the design of ESG index/weighting approaches** (e.g., methods for grouping different indicators, weights for different group indicators, and qualitative judgment that contributes to final scores), and
- **ways to present the results** (e.g., in alphabetical or numerical terms, and their scales).

The OECD finds that ESG ratings vary widely depending on the provider chosen, which can occur for a number of reasons, such as different frameworks, measures, key

²³ ASEAN to Develop Sustainable Finance Taxonomy for Southeast Asia, April 1, 2021.

<https://www.eyeonesg.com/2021/04/asean-to-develop-sustainable-finance-taxonomy-for-southeast-asia/>

²⁴ Bloomberg (2021), ESG assets may hit \$53 trillion by 2025, a third of global AUM.

²⁵ OECD, ESG investing and climate transition: market practices, issues and policy considerations, 2021



indicators and metrics, data use, qualitative judgement, and weighting of subcategories.²⁶ This lack of comparability of ESG metrics, ratings, and investing approaches makes it difficult for investors to find consistent and credible measurement of ESG performance for assets, accurately assess the trade-off between managing ESG risks and financial performance, and aligning investments with sustainability goals, including low greenhouse gas emission portfolios or climate transition. There are different reasons for the lack of comparability, including but not limited to the lack of transparency of different rating methodologies.

With the same issue in mind, IOSCO found that there is a lack of transparency about methodologies underpinning these ratings or data products and that they only cover limited industries and geographic areas, thereby leading to gaps for investors seeking to follow certain investment strategies. IOSCO is conducting relevant work for exploring solutions and published a Consultation Report on ESG Ratings and Data Products Providers in July 2021.²⁷

The practices associated with ESG investing also vary considerably, depending on the comprehensiveness through with the asset manager seeks to utilize the ESG framework. Approaches can range from simply excluding certain firms categorically (e.g., based on moral considerations) to full integration of sustainability issues into the investment processes, governance, and decisions. Approaches are not mutually exclusive, and portfolios could simultaneously apply more than one. Some of the prevalent sustainable ESG investing approaches include:

- Exclusion or avoidance, which signifies exclusion of corporates and governments whose behaviours do not align with basic societal value (e.g., manufacturing controversial weapons, activities not aligned with ethical standards such as tobacco, alcohol and casinos, etc.);
- Norms-based or inclusionary screening, which pursues the inclusion or higher representation of issuers that are compliant with international norms;
- Tilting portfolio exposures towards issuers with higher ESG and away from lower ESG scores;
- Thematic focuses within at least one of the environmental, social or governance areas;
- Impact focus, which seeks to improve ESG performance with achieving the benefit of financial returns.

²⁶ *ibid*

²⁷ <https://www.iosco.org/news/pdf/IOSCONEWS613.pdf>



- ESG integration, which refers to systematic and explicit inclusion of ESG risks and opportunities in all key aspects of an institutional investors' investment process.

1.2.3. Verification and labelling

Verifications and labels have been created to market sustainable investment products. Verification and labels can help create a coherent investment universe for green financial instruments and products allowing investors to identify sustainable investments. They lower transaction costs for investors by reducing the need to check and compare information to ensure that financial instruments are transparently green and sustainable.

Most verification services are provided by privately-owned verifiers, certifiers, second opinion providers and third-party reviewers which could be presented in the form of verification, certification or assurance reports. The most frequently used verification services are for green bond labelling, while some bank loans, securitization products, and Private Equity (PE) investments are beginning to use these services.

There is a growing number of verifiers in the market providing verification services to green or sustainable financing instruments, most notably for green bonds. Some of them are providing verification services against several of the major taxonomies and/or principles to identifying sustainable investments, while some are operating in a single market under a specific context and set of policies, such as a national taxonomy. Verifications are used in the pre-issuance process or as part of the post-issuance disclosure process.

1.2.4. Alignment tools and approaches for products and institutions

There are a number of alignment tools and approaches that identify sustainable investments at the product and institution level. In some instances, these tools can refer to an external set of principles or a taxonomy, while in other cases the tools themselves articulate the parameters for identifying sustainable investments or measuring the sustainability performance of assets or institutions.

● Portfolio alignment tools

Some data providers and other public/private-led initiatives have developed tools to assess the alignment of investment portfolios with sustainability goals. Most of these tools have emerged in the climate space as instruments for investors and financial institutions to assess the needed steps to align an investment portfolio with the Paris Agreement in the intermediate term, given the portfolio's unique composition.



For investors, forward-looking portfolio alignment tools describe if companies in their portfolios are on track with their transition path. Achieving the goals of the Paris Agreement leads to commercial opportunities for companies that position themselves optimally and implement necessary structural changes early on. At the same time, companies that do not adjust quickly enough risk a significant impact on their profitability. Portfolio alignment tools available today show various degrees of sophistication:

- Binary target measurements: these tools reflect the per cent of investments in a portfolio that declared Paris-aligned targets.
- Benchmark divergence models: based on forward-looking climate scenarios, such as those developed by the International Energy Agency, these tools measure on an individual company level its trajectory with constructed normative benchmarks.
- Implied temperature rise (ITR) models: these tools extend benchmark divergence models, by aggregating the company level divergence from benchmarks and translating it into the form of a temperature score.

● Bonds

Green bonds have catalysed the development of sustainable investment products. In the early stages, green bonds were issued primarily by development banks and were generally self-labelled as green which was accepted by the market. However, as the market started to grow and attract a more diverse range of issuers, standards and certification mechanisms were developed to ensure the credibility of the market.

A bottom-up or market-led approach is used by the Climate Bonds Standards (CBS). The CBS has been developed by the Climate Bond Initiative (CBI), an international non-profit organisation funded by grants from non-profit and government sources and establishes sector-specific eligibility criteria to judge an asset's low carbon value and suitability for issuance as a green bond. Assets that meet the CBI standard are then eligible for Climate Bond Certification, after an approved external verification that the bond meets environmental standards, and that the issuer has the proper controls and processes in place.

The CBS was developed based on the governing framework contained in Green Bond Principles (GBP). GBP, administered by ICMA, are voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the green bond market. The GBP does not provide a whitelist of eligible projects or technical screening criteria, but guidance to issuers on the key components needed to issue a green bond. Issuers who intend to launch a green bond are required to build a Green



Bond Framework, which should align to four components, namely: (i) the use of proceeds for environmentally sustainable activities; (ii) a process for determining project eligibility; (iii) management of the proceeds in a transparent fashion that can be tracked and verified; and (iv) annual reporting on the use of proceeds.

Social bonds recently emerged as another segment of the sustainable bond markets. Along with the expansion of the green bond market, some investors and issuers have begun to explore the use of proceeds for projects with positive social impact²⁸. To guide the social spending of bond proceeds, ICMA has put together the Social Bond Principles (SBP). Like the GBP, the SBP do not provide a comprehensive list of what is eligible social spending; rather, the principles recommend a clear process and disclosure for issuers, which investors, banks, underwriters, arrangers, placement agents and others may use to understand the characteristics of any given Social Bond.

Besides market-based initiatives, the EU has recently proposed to introduce a common framework of rules regarding the use of the designation “European green bond”, intended for bonds that pursue environmentally sustainable objectives aligned with the EU Taxonomy.

● Investment funds

A proliferation of labels relating to investment funds and strategies have emerged over the past two decades. In the equity space, there has been a growth of funds self-labelled with green, climate, ESG, Socially Responsible Investing (SRI), ethical or other terms, but no consensus of what it means in practice. Regulators and the private sector have attempted to develop guidance on what criteria needs to be met to be labelled as a sustainable investment. For example, some private sector led initiatives have developed guidance that clarifies how to construct a sustainable investment portfolio, such as the definition of sustainable development investing (SDI) developed by the GISD Alliance.

These labels and definitions can be used to signal how well a collection of investment aligns with the SDGs and can have varying levels of sophistication, including the percentage of the portfolio consistent with net-zero targets, a metric reflecting the implied degree of warming, and deviation of the portfolio from a sustainability target or

²⁸ In 2020, social bond issuance grew to \$249 billion mainly to fund Covid-related relief packages by government agencies and development banks (in comparison with \$290 billion green bonds). Bonds with a mix of both social and green spending are usually called sustainability bonds and issuance in 2020 amounted to \$169 billion. Source: IPSF and UNDESA, Improving compatibility of approaches to identify, verify and align investments to sustainability goals, as an input paper to this report, 2021. <https://g20sfwg.org/wp-content/uploads/2021/09/G20-SFWG-DESA-and-IPSF-input-paper.pdf>



benchmark. Some of these investment fund labels can be self-designated without transparency in the approach.

Climate benchmarks are market benchmarks where the underlying assets are selected, weighted, and excluded to meet defined climate criteria. Examples of climate benchmarks include alignment with the goals of the Paris agreement and portfolios that are aligned with the transition to decarbonization. In some jurisdictions, a set of minimum technical requirements are used to determine whether a financial service firm's benchmarks or indices are climate-aligned.

- **Strategies and targets**

Various institutions have established strategies or targets to meet the goals of the Paris Agreement, the 2030 Agenda, or other sustainability-related goals. For example, an increasing number of institutions have specifically committed to reaching net-zero financed emissions by the mid-century. Several others, particularly those in carbon-intensive sectors are establishing transition strategies and/or action plans. Making a net-zero commitment has become increasingly prevalent among governments, real economy companies, and financial institutions, but the manner in which a net-zero commitment is constructed and implemented can vary from entity to entity. Institutions can use metrics, emissions targets, and transition pathways as a way of providing information to investors that can improve market functioning, price discovery, certainty, and transparency. There are various initiatives that support these commitments, including those that help firms establish strategies and interim targets to reach their final targets. For example, the ICMA's Climate Transition Finance Handbook is a market-led, principles-based approach to promote transition finance by requiring that transition strategies be aligned with the goals of the Paris Agreement. Measures to increase the credibility of strategies and targets, and to strengthen accountability to meet these commitments, are necessary to avoid greenwashing and more broadly to ensure that the financial sector sticks to the (voluntary) commitments made to support climate goals.

Around 1,000 companies have already committed to cutting greenhouse gas emissions in line with the science-based targets. The same group has launched the development of nature-related science-based targets and guidance to define how companies can assess, prioritize, measure, address and track their impacts and dependencies on natural ecosystems.



1.3. Challenges and Key Issues

A number of issues are emerging in our stocktaking analysis and in the private sector consultation conducted by the SFWG. These include the complexity of navigating various sustainable alignment approaches, lack of capacity in some emerging and developing economies and the need for jurisdiction-specific flexibility, low data availability and quality, and limited coverage of these approaches against the scope of SDGs and other sustainability goals, and the need to consider the climate transition.

1.3.1. Complexity and costs of navigating various alignment approaches

The proliferation of public and private-led alignment approaches for sustainable finance, including taxonomies, ESG rating methodologies, and verifications has brought an increased complexity for the market and the risk of fragmentation. The lack of consistency, comparability and interoperability among different approaches could pose challenges to various actors, at many levels and from different perspectives (such as those of countries with less advanced capital markets and with a greater share of SMEs), including market segmentation, increases in transaction costs, and higher risks of green- and SDG-washing.

- A large number of sustainable finance taxonomies have been and are being developed by various bodies, including governments, regulators, industry associations and financial institutions.
- Several dozen ESG rating agencies or data providers, including S&P, Moody's, Fitch, MSCI, Bloomberg, Reuters, Sustainalytics, Carbon Disclosure Project (CDP), FTSE Russell, Dow Jones Sustainability Indices (DJSI), Morning Star, Trucost, Zhongzheng Index Co, Central University of Finance and Economics (CUFE), are developing their own methodologies, with low correlations of ESG scores across different rating providers.
- At least 70 verifiers are developing various labelling schemes for sustainable assets. Major verifiers in the market include CICERO, DNV, E&Y, PwC, Deloitte, KPMG, Sustainalytics, Bureau Veritas, China Chengxin Credit Rating, CECEP Consulting, China Lianhe Equator, SynTao, and HKQAA. Their verification reports cover different contents and indicators and are expressed in very different forms.

Investors, as well as corporates/issuers, are the first impacted as they may see their operations and compliance costs increased by the need to align with different approaches. In general, using inputs from different sources is costly and inefficient, and managing different sets of standards may prove cumbersome. For example, for green bonds issued in different markets with different taxonomies and verification standards,



the issuers need to incur additional costs of explaining and mapping their sustainability performance against different rules, and in some cases involving multiple verifications. In this context, having to comply with different frameworks creates a higher “information cost” related to the different sets of alignment approaches. This is even more costly for smaller companies and those who may have limited capacity and resources.

1.3.2. Data inconsistency as a result of fragmented alignment approaches, and challenges with the availability, quality and comparability of data

The availability and quality of data for the implementation of sustainable investment approaches by investors also presents a hurdle. Investors generally need data to operationalize frameworks for sustainable investment and compare the relative sustainability performance of companies and projects they want to finance.

There are four main issues that many investments face in this context:

- Low availability, quality and consistency (hence comparability) of data published by corporates (especially for non-listed companies and SMEs).
- Lack of data on the company’s products/services/assets and geographical footprint.
- Challenges in impact measurements given the absence of sector/industry-specific metrics.
- Absence of forward-looking data.

The fragmentation of alignment approaches might also cause a data inconsistency issue, as sustainability data created under different taxonomies, ESG/SDG rating methods, and verification approaches are not comparable and interoperable. While the availability and comparability of sustainability data is already a big issue that will be discussed in the “sustainability reporting” chapter of this report, the proliferation and fragmentation of alignment approaches and related metrics could exacerbate this problem. This situation can increase the cost for investors, as they may need to purchase many different sets of sustainability data and devote resources for “translating” them into a comparable and compatible set for analysis. Regulators and international organizations may also find it a costly exercise for performance measurement and risk analysis if data presented by different regulated entities are using different taxonomies and market data are not comparable. The proliferation of different approaches to ESG and verification methodologies may also create the risk of greenwashing and lead to concerns about the quality of data. Technological developments may improve data availability in the future, and help to ameliorate issues of data inconsistency, availability, and quality.



1.3.3. Inadequate flexibility for inclusion and applicability across jurisdictions, and capacity constraints

Some of the existing alignment approaches are not flexible enough to accommodate the individual jurisdiction characteristics, including the level of market sophistication, to ensure inclusion and applicability. Specificities among countries, regions, and jurisdictions must be duly considered and accounted for. International cooperation could allow for progress in achieving better alignment across sustainable finance frameworks, including in the integration of transition finance considerations, and move towards better comparability and interoperability while providing flexibility for the development and use of tools suited to the context and fit for purpose.

While many countries have developed or are in the process of developing their own alignment approaches, they are not universally available especially in many developing and emerging market economies. For those countries that have recognized the importance of a national sustainable financial system, one of the challenges they face is the lack of capacity or resources for the development of alignment approaches such as taxonomies or high-level guiding principles. The underdevelopment and lack of depth of local capital markets in certain economies act as a barrier to fully seizing the development and growth opportunities arising from sustainable finance. The international community could provide technical support to these countries, to help them develop or adopt existing approaches that take into account some of the global good practices, and in a way that would not further exacerbate the fragmentation of the global landscape of approaches.

1.3.4. Limited coverage of some alignment approaches

Many alignment approaches have so far been largely focused on climate-related objectives and would benefit from being extended to other sustainability objectives including nature and biodiversity. Sustainable investment should help achieve all sustainability goals, building on lessons learned from climate-aligned investment approaches which are more advanced but need to be more aligned. The SDGs provide the ideal starting point for taking this broader approach and several private data providers have started developing taxonomies linked to the SDGs. While the SDGs have been developed for governments, they could serve as a basis for defining indicators or technical criteria to be applied in some sectors and industries. For example, an indicator related to SDG 2 on zero hunger could be the amount of food waste generated by companies active in the consumer staples sector. The GISD alliance has recognized value in having sector-specific metrics that would enable a better assessment of the companies' impact on sustainable development. They have started identifying SDG-related sector-specific metrics for eight industries. These metrics could be used in the



future for the development of approaches to identifying sustainable investments that consider more sustainable development objectives. In addition, the need to consider the climate transition has also been raised as an option for future work.

1.3.5. Inadequate consideration of climate transition

Many alignment approaches are currently focused on promoting those activities or financial instruments that are highly aligned with sustainability or climate goals (e.g., low greenhouse gas emission activities). But there is a growing view among market participants and jurisdictions that it is equally important for the financial sector to support the transition, e.g., activities that reduce GHG emissions and pollution over time, and expand the scope of eligible investments beyond current taxonomies and other alignment approaches²⁹. Adequate consideration of transition issues may require focused future work on tailoring transition pathways to specific sectors and operating geographies, and on metrics, reporting, and disclosure.

Given the importance of integrating transition considerations into approaches of aligning capital flows/investments with sustainability goals, continued engagement with the private sector, international organizations, networks and associations, as well as coordination among different jurisdictions on financing the climate transition, (including its definition, transition pathways, incentives, metrics for monitoring and reporting), could present a priority area for further work. The work could draw on various approaches, including incorporating top-down or bottom-up approaches into industry-specific transition roadmaps that articulate transition pathways for individual sectors and key regions for just transition.

1.4. High-level Principles and Recommendations

The following section presents some high-level voluntary principles for developing alignment approaches and recommendations for international coordination, to enhance comparability, interoperability, and as appropriate the consistency, of different alignment approaches. The first part identifies voluntary principles for countries/markets that intend to develop their own alignment approaches, and the second part proposes recommendations for international coordination among existing alignment approaches, including taxonomies, ESG rating methodologies, verifications and others. In all cases,

²⁹ Tandon, A. (2021), "Transition finance: Investigating the state of play: A stocktake of emerging approaches and financial instruments", OECD Environment Working Papers, No. 179, OECD Publishing, Paris, <https://doi.org/10.1787/68becf35-en>.



the development process should take into account considerations such as domestic regulatory frameworks, policy objectives, and use cases.

1.4.1. Voluntary principles for countries/markets that intend to develop their own approaches

Principle 1: Ensure material positive contributions to sustainability goals and focus on outcomes. Approaches to align investments with sustainability goals should aim to create a positive contribution to existing and recognized international sustainability goals (e.g., Paris Agreement and SDGs), including environmental, climate, biodiversity and other social objectives, and to ensure that such contribution entail material outcomes. This represents a clear consensus both in the market and among public stakeholders in different jurisdictions and is already stated as a key principle of most approach designers.

Principle 2: Avoid negative contribution to other sustainability goals (e.g., through do no significant harm to any sustainability goal requirements). Approaches to align sustainable investments should avoid negative contributions to other sustainability goals and provide guidance in terms of accounting for secondary impacts, which could take the form of guidance to do no significant harm to any of the 17 SDGs, despite a positive contribution to some other SDGs. For example, in the case of a sustainable finance taxonomy, projects that reduce pollution but generate more carbon emissions, should not be included in the sustainable finance taxonomy. To the extent that an alignment approach involves a process for implementation, it should also introduce safeguards to ensure that a positive contribution to one objective is not going to be outweighed by negative impacts on other environmental and social objectives.

Principle 3: Be dynamic in adjustments reflecting changes in policies, technologies, and state of the transition. Approaches for alignment of sustainable investments would be most effective if they are reflective of market changes and the development of green and sustainable technologies, as well as the change of both domestic and international policy agendas and priorities. Dynamism will also be needed in response to improvements over time in the availability and quality of data and metrics, and to encompass the changing nature of the transition and achievement of targets. Such dynamic adjustments could take the form of changing coverage and technical standards. Approaches that initially focus on climate should consider the need to expand their coverage to include other sustainability goals such as the environment, biodiversity and social aspects of sustainability; and approaches that currently focus on “pure green” activities could also consider expanding their coverage to include transition activities.

Principle 4: Reflect good governance and transparency. Effective implementation of approaches and tools for alignment of sustainable investments, especially taxonomies,



should clarify a process that governs their usage, including good practices for key aspects such as disclosure and verification of the use of proceeds, and assessment of the environmental/climate impact of the project. Approaches themselves and requirements for their implementation process will also need to be transparent. Approaches may define, for example, minimum requirements for disclosure, certification and verification.

Principle 5: Be science-based for environmental goals and science- or evidence-based for other sustainability issues. Approaches to align sustainable investments should be objective in nature, supported by clearly defined and disclosed metrics, thresholds, or technical screening and assessment criteria that align with the best available science and technologies, where appropriate, and are internationally interoperable. When science-based metrics are not feasible, the approaches adopted should be fact-based and subject to verification. A scientific basis is particularly relevant to environment- and climate-related alignment approaches, but objective evidence should support approaches and tools that address some other sustainability issues, especially social and governance issues.

Principle 6: Address transition considerations. Approaches to align sustainable investments should consider how to support a credible, just and affordable climate transition, which could include elements such as definitions, credible transition pathways, disclosures and verification requirements.

1.4.2. Recommendations for international coordination

At the global and regional level, efforts should be made to improve coordination on enhancing the comparability, interoperability, and as appropriate the consistency, of different alignment approaches. Further coordination is necessary to deepen the understanding of how approaches relate to one another and to refine areas of work and recommendations for enhanced comparability and interoperability.

Recommendation 1: Jurisdictions which intend to pursue a taxonomy-based approach to consider developing sustainable finance taxonomies using the same language (e.g., international standard industry classification and other internationally recognized classification systems), voluntary use of reference or common taxonomies, and regional collaboration on taxonomies.

If taxonomies are developed using different activity classification methods, comparison between these taxonomies would be difficult, and translation of these taxonomies would be costly. It is recommended that countries/regulators/market bodies intending to develop new taxonomies consider the use of internationally recognized classification (e.g., United Nations (UN) endorsed International Standard Industrial Classification (ISIC) and other industrial classifications derived from ISIC such as the Statistical Classification of



Economic Activities in the European Community (NACE) and Standard Industrial Classification (SIC)), which can help enhance comparability and interoperability across taxonomies and reduce translation costs. Different markets can use reference or common taxonomies on a voluntary basis.³⁰ Such use can facilitate cross-border sustainable financial flows for example by reducing the costs of verifications. For jurisdictions or markets that want to use a taxonomy, but do not have the resources to develop their own taxonomies, they can also choose to adopt an existing taxonomy. Regions with a large number of relatively small economies or markets (e.g., Africa, Central Asia, and Latin America) can consider regional collaboration on taxonomies, including development of taxonomies, to avoid market segmentation and illiquidity while promoting cross-border investment.

Recommendation 2: Collaboration and active engagement of service providers, where consistent with applicable laws, with appropriate international organizations and financial authorities to enhance comparability, interoperability, and transparency of approaches, including forward-looking portfolio alignment tools, ESG rating methodologies, verification and labelling approaches.

Acknowledging existing work in this field, the G20 SFWG will invite ESG rating agencies, market participants and other stakeholders to improve comparability and increase transparency of selection of ESG indicators, scoring methods and forms of presentation, to enhance the quality of ESG data and their usefulness. Verifiers, certifiers, second-opinion providers, third-party reviewers and relevant stakeholders should also seek to improve comparability and transparency of verification and labelling of sustainable activities and assets, including on minimum content requirements, key indicators, and forms of report presentation and labelling. These works shall be done in line with applicable domestic regulatory frameworks. Appropriate international organizations can facilitate the engagement of these service providers with stakeholders including market regulators.

Recommendation 3: Relevant international organizations, networks or initiatives to further advance work towards better understanding the technical aspects and interlinkages of existing and emerging alignment approaches, as well as good practices, and develop specific recommendations for enhanced comparability and interoperability.

The G20 SFWG will invite international organizations to work on and further understand the technical aspects and foundational elements of existing and emerging alignment

³⁰ In November 2021, the IPSF will publish a Common Ground Taxonomy report based on the EU and China taxonomies.



approaches, and on identifying interlinkages and best practices, where feasible, to enhance interoperability. This work will provide a valuable foundation for future recommendations and action areas for enhanced comparability and interoperability, also taking into consideration other ongoing international workstreams. To conduct this work, it would be beneficial to leverage existing public and private-led platforms.

Recommendation 4: Better integrate transition finance considerations into sustainable finance alignment approaches, with a focus on interoperability with existing and emerging approaches for sustainable finance, based on the mapping and review of existing and emerging approaches by the SFWG and appropriate international organizations.

There is a need to better integrate the climate transition considerations into sustainable finance alignment approaches. It is important to develop adequate metrics that measure transition performance, including incorporating transition into sustainable finance alignment approaches (e.g., roadmaps, portfolio alignment tools, taxonomies, principles, labels, etc.), and refining strategies and targets to facilitate the transition. Transition considerations could be integrated by incorporating transition activities with credible decarbonization pathways into sustainable finance taxonomies, expanding ESG metrics to include measurement of transition performance, enhancing transparency of transition activities and strategies via proper verification and disclosure, and enhancing credibility and transparency of portfolio alignment tools and strategies.



Overcoming information challenges by improving sustainability reporting and disclosure

2.1. Background

Improving the consistency, comparability, and reliability of sustainability-related information is foundational to building a sustainable financial system that supports the Paris Agreement and SDGs. Companies began producing Sustainability and Corporate and Social Responsibility (CSR) reports several decades ago. The practise has become more widespread internationally since the 1990s, with further advances in recent years. However, it has been widely observed that sustainability-related reporting remains incomplete and inconsistent across companies and jurisdictions and that the voluntary nature, and a growing number of sustainability-related disclosure frameworks, potentially lead to selective disclosures. As a result, investors may not be able to receive the sustainability-related information that is material to their decisions.

This is a particularly important consideration in managing sustainability-related risks opportunities and impacts in the context of the transition to a lower-carbon economy. The need to better understand how companies are managing these risks and opportunities has been a key driver of investors' and other market participants' demand for more consistent, comparable and reliable sustainability-related disclosures by corporate issuers. It has been further noted by many participants in the G20 SFWG engagement activities with the private sector and international organizations that, with incomplete and inconsistent data on sustainability risks and impacts, the market may misprice financial assets and misallocate capital. This could harm market integrity and undermine markets' ability to support the allocation of capital towards sustainability goals.

Incompleteness and inconsistency in sustainability-related disclosures pose a major challenge to market fairness, efficiency, transparency and integrity. Without the requisite data, firms may be unable to verify that they are pursuing genuinely sustainable investment strategies. They may also be unable to demonstrate to consumers the sustainability-related characteristics of their products and performance against their stated objectives.

Securities regulators and capital market authorities' objectives include protecting investors, maintaining fair, efficient and transparent markets and seeking to address systemic risks, as well as supporting market integrity by requiring transparency and disclosure of information that is material to investment decisions. However, frequently,



sustainability reporting is not integrated into issuers' periodic reporting structure but is instead treated as a separate and often siloed reporting activity within companies.

The complexity of sustainability-related reporting also reflects the fact that investor preferences are evolving over time, driven by a pressing need to account for social and environmental impacts. The growing focus on nature-related concerns is reflected in the increasing demand for nature-related reporting by investors and regulators. For instance, in 2020, pension funds and other investors managing \$6.5 trillion in assets publicly called for a “framework to measure biodiversity impacts”³¹, arguing that “both positive and negative impacts should be captured by metrics, allowing investors to identify beneficial and harmful investments”.

2.2. Stocktaking of Existing Frameworks for Sustainability Reporting

Three trends have emerged over the last 18 months to accelerate progress towards a comprehensive corporate reporting system:

- There has been a groundswell of demand from all stakeholders to understand the connection between sustainability topics and financial risk and opportunity, along with the contribution of business to achieving the SDGs. Large mainstream investors are increasingly integrating sustainability information into investment decisions and calling for improved disclosure.
- Financial authorities and leading private-sector standard-setters are collaborating to work towards the potential establishment of a single international body to develop, in the public interest, a set of high quality, understandable, enforceable, auditable and globally accepted sustainability disclosure standards to help investors and other participants in the world's capital markets in their decision-making.
- Policymakers and regulators are moving to determine their response. Some jurisdictions have already introduced mandatory/compulsory or semi-compulsory sustainability disclosures to listed companies.

A number of frameworks already exist to help organisations assess and disclose sustainability-related information. These frameworks can support both companies' disclosures and firms' investment processes, by specifying a structure, definitions, metrics and methodologies. For climate-related financial disclosures, the TCFD

³¹ Pensions & Investments (2020). [Investors urge development of biodiversity metrics](#).



framework has become increasingly recognised in the market, and by private-sector standard-setters, as a suitable basis. However, these existing frameworks are typically applied and selected only on a voluntary basis, and the market has not converged around a consistent framework. The most commonly used international frameworks are summarised in Figure 2 below.

Figure 2: Most commonly referenced sustainability-related frameworks, principles and guidance

Global Reporting Initiative (GRI)	Sustainability Accounting Standards Board (SASB)	Taskforce on Climate-related Financial Disclosures (TCFD)	Sustainable Development Goals (SDGs)
<ul style="list-style-type: none"> The GRI, established in 1997, was the first to promote a set of sustainability reporting standards. The standards are directed at a broad scope of stakeholders. They comprise: <ul style="list-style-type: none"> a set of universal standards, covering general disclosures and management approach three sets of topic-specific standards, covering key metrics related respectively to economic, environmental and social matters. 	<ul style="list-style-type: none"> SASB was established in 2011. The standards aim to serve the needs of the investor community. A key conceptual foundation for SASB's standards is the concept of financial materiality. The standards cover 26 ESG topic areas and apply at the industry level. SASB identifies those metrics deemed to be financially material in each of 77 industries, across 11 sectors. 	<ul style="list-style-type: none"> The TCFD published its recommendations in 2017. The recommendations provide a structure and framework for considering and reporting on climate-related risks and opportunities in four thematic areas: governance; strategy; risk management; and metrics and targets. To allow for continued evolution in organisations' capabilities, the TCFD's recommended disclosures are largely principles-based. 	<ul style="list-style-type: none"> The SDGs form the core of the United Nations' 2030 Agenda for Sustainable Development, which was adopted in 2015. They comprise 17 goals and a total of 169 targets, across five themes: people; planet; prosperity; peace; and partnership. Companies and financial services firms increasingly apply the SDGs to demonstrate that their decisions and actions are consistent with, or directed towards, helping to achieve particular goals or targets.

Source: IOSCO (2021). Report on Sustainability-related Issuer Disclosures. Input paper prepared as a contribution to the G20 SFWG.

Recognising this, momentum has been building in both public and private sector initiatives to enhance the consistency, comparability and reliability of sustainability-related disclosures. Some initiatives are voluntary and in the form of recommendations while some are based on regulatory standards and may thus entail different degrees of consistency and enforcement. This work aims to support investors' evolving needs and improve the functioning of markets by promoting a global sustainability reporting framework. The following initiatives, among some others, are the most commonly used:

2.2.1. IOSCO's Sustainable Finance Taskforce

In April 2020, the International Organization of Securities Commissions (IOSCO) published its report on Sustainable Finance and the Role of Securities Regulators and



IOSCO³², which provided an overview of existing sustainable finance initiatives, both by regulators and the industry, and a detailed analysis of the most relevant ESG-related initiatives and third-party frameworks and standards. It highlighted three recurring themes: (i) multiple and diverse sustainability frameworks and standards, including sustainability-related disclosure; (ii) a lack of common definitions of sustainable activities; and (iii) greenwashing risk and other challenges to investors.

At the same time, IOSCO established a Board-level Sustainable Finance Taskforce (STF) to carry out work on corporate sustainability disclosure, asset managers' disclosure and investor protection issues and the role of ESG data and rating providers. In developing its work, IOSCO's STF has coordinated with several other disclosure-related initiatives across international organisations. These include workstreams at the Financial Stability Board (FSB), the Network for Greening the Financial System (NGFS), and the International Platform on Sustainable Finance (IPSF).

IOSCO's STF work in the area of corporate sustainability disclosure identifies core elements of standard-setting that could help meet investor needs and provides guidance to the IFRS Foundation to develop recommendations for the ISSB as it progresses its work to develop an initial climate reporting standard, building on the TCFD's recommendations and other existing voluntary principles and frameworks. IOSCO's STF also provides input to the IFRS Foundation on governance features, and the development of a multi-stakeholder expert consultative committee within the IFRS Foundation. This is essential to facilitating interoperability with complementary standards to meet the needs of other stakeholders or jurisdiction specific requirements.

IOSCO has been the lead knowledge partner on sustainability disclosures for the SFWG in 2021. The Report on Sustainability-related Issuer Disclosures, published in June 2021, will feed directly into the SFWG's work.

2.2.2. FSB's Taskforce on Climate-related Financial Disclosures (TCFD)

In 2017, the TCFD, which the FSB established, published recommendations on climate-related financial disclosures³³, spanning four pillars: governance, strategy, risk management, and metrics and targets, with 11 specific recommended disclosures under these four pillars. More than 2,000 organisations are public supporters. While originally introduced for voluntary adoption by nonfinancial and financial firms, the TCFD's

³² IOSCO (2020). Final Report. Sustainable Finance and the Role of Securities Regulators and IOSCO. <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD652.pdf>

³³ TCFD (2017). Recommendations of the Task Force on Climate-related Financial Disclosures. <https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf>



recommendations are increasingly embedded in legal and regulatory frameworks. For instance, the EU embedded in 2017 the TCFD framework in its corporate disclosure regulation on non-financial reporting³⁴, and the European Commission recently published a proposal for a Corporate Sustainability Reporting Directive³⁵ which specifically integrates all the key concepts of the TCFD framework. An increasing number of other jurisdictions, including most G20 members, and their financial authorities are implementing the TCFD's recommendations or are actively consulting or working on relevant proposals.³⁶

2.2.3. International Financial Reporting Standards (IFRS) Foundation

The IFRS Foundation is working to establish an International Sustainability Standards Board (ISSB) to sit alongside the International Accounting Standards Board (IASB), on the back of a consultation with market participants published in September 2020³⁷. Feedback received from almost 600 respondents around the world evidenced widespread support for the IFRS Foundation to play a key role in global sustainability reporting. As a result, the IFRS Foundation established a Technical Readiness Working Group to develop recommendations for the ISSB as it develops an initial climate reporting standard, building on the TCFD's recommendations and other existing voluntary principles, frameworks and guidance. The Trustees will consider the prototype³⁸ proposed by the alliance of five sustainability reporting organizations³⁹ ("the Alliance") for an approach to climate-related disclosures and provide recommended enhancements for further development of the prototype as a potential basis for the new board to develop climate-related reporting standards. The Foundation is working towards finalising the design of the new ISSB ahead of COP 26 in November 2021.

³⁴Communication from the Commission — Guidelines on non-financial reporting (methodology for reporting non-financial information) [https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52017XC0705\(01\)](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52017XC0705(01))

³⁵ Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0189>

³⁶ See FSB (2021), [Report on Promoting Climate-Related Disclosures](#)

³⁷ IFRS Foundation (2020). Consultation Paper on Sustainability Reporting. <https://www.ifrs.org/content/dam/ifrs/project/sustainability-reporting/consultation-paper-on-sustainability-reporting.pdf>

³⁸ CDP, CDSB, GRI, IIRC and SASB (2020). Reporting on enterprise value Illustrated with a prototype climate-related financial disclosure standard. https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Reporting-on-enterprise-value_climate-prototype_Dec20.pdf

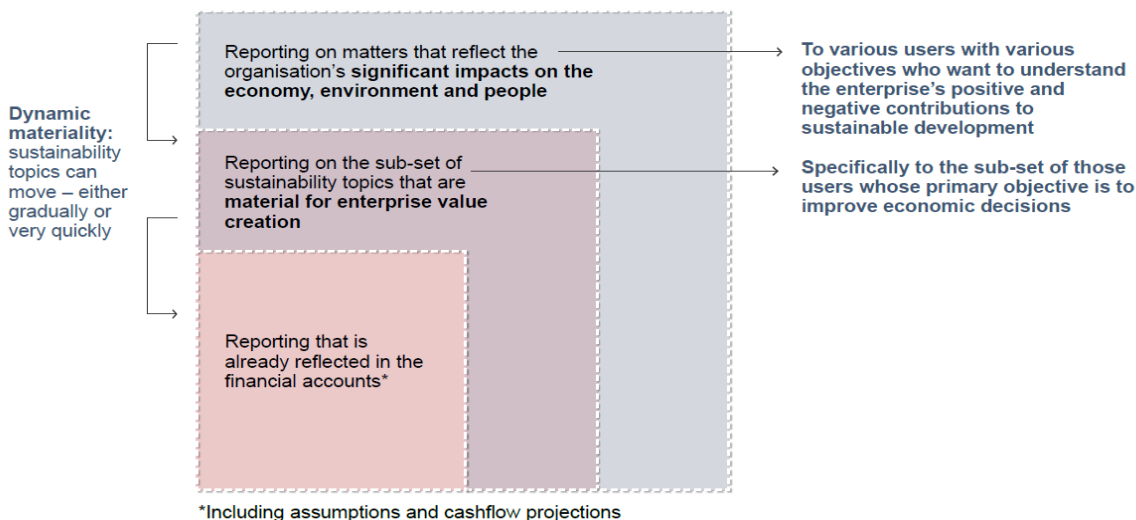
³⁹ CDP, CDSB, GRI, IIRC and SASB (2020). Statement of Intent to Work Together Towards Comprehensive Corporate Reporting. <https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work-Together-Towards-Comprehensive-Corporate-Reporting.pdf>



Box 2: Financial vs. environmental and social materiality in sustainability-related reporting

In September 2020, the Alliance of five sustainability reporting organizations published a ‘statement of intent’⁴⁰ to work together towards a ‘comprehensive, globally accepted, corporate reporting system’ that meets the information needs of different stakeholders. The statement introduces the conceptual device of ‘nested boxes’ to illustrate how different sets of sustainability information serve different purposes, how they relate to one another (Figure 3).

Figure 3: Nested sustainability information



Source: Alliance's Statement of Intent, September 2020.

The concept of nested boxes demonstrates that there can be significant overlap in the sustainability information reported on the organisation's impacts on the economy, environment and people, and that reported through an ‘enterprise value’ lens. In particular, a company's external sustainability impacts can feed back to a company's financial performance and position in the short-, medium-, or long-term. Information on

⁴⁰ CDP, CDSB, GRI, IIRC and SASB (2020). Statement of Intent to Work Together Towards Comprehensive Corporate Reporting. <https://29kjwb3armds2g3qi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work-Together-Towards-Comprehensive-Corporate-Reporting.pdf>



these impacts is therefore relevant for investors' determination of a company's enterprise value – i.e., its future value creation and cash flows.

Where this is the case, information about a company's impacts on sustainability (i.e., information on the company's performance in respect of environmental and social objectives, such as those contained in the Paris Agreement) could be captured by standards that adopt an enterprise value lens, as these have the potential to become material to the company's future prospects.

Across all sectors and industries, companies depend (to varying degrees) on people and the natural environment, as well as financial capital, to create and preserve enterprise value. Impacts on people and the natural environment may not be captured on company balance sheets, but often may be critical for investors, as part of their sustainable investment strategies or to assess companies' ability to create value in the future. Many of a company's external impacts, including how the company ensures the preservation of social and environmental systems, could therefore be expected to influence investors' decisions.

The relationship and overlap between the different categories of information will continue to evolve. Over time, the sustainability matters that a company assesses to be material for disclosure to investors can change in response to developments in industries, stakeholder views, regulations, and investor preferences. This is referred to as dynamic materiality. Companies' impacts and dependencies on stakeholders differ across sectors/industries, geography and over time. Therefore, the materiality to the enterprise value of different sustainability factors will similarly differ on all of these dimensions.

There are reasons to believe that the trend going forward will be a convergence of informational needs under the different materiality lenses. Importantly, the sustainability performance of businesses and institutional investors across the globe is increasingly in the spotlight as societal awareness of sustainability matters rises not only in respect to climate change but also the breadth of environmental and social issues, from biodiversity to income equality, to diversity and inclusion. These expectations can affect a company's business model over time and therefore its enterprise value.



2.2.4. Jurisdictional Approaches to Implementing Sustainability Disclosures

Authorities in a number of jurisdictions have already taken measures to implement sustainability disclosures, such as the European Union⁴¹. Jurisdictions have taken different approaches, with some adopting mandatory sustainability reporting requirements, and others issuing various forms of guidance or supervisory expectations. Efforts to promote international coordination between reporting frameworks and reduce fragmentation should, therefore, take into account existing work done by national and regional authorities. The FSB's Report on Promoting Climate-related Disclosures (2021) provides a number of detailed case studies that describe a sample of jurisdictions' implementation approaches.

2.2.5. National Initiatives to Promote Digitization of Sustainability Reporting

Several jurisdictions have started to strategically work on their digital data infrastructure to scale sustainability reporting. The UK has worked to address the data gap for physical climate risk assessment through spatial finance, which is the deployment of earth observation data to help green financial decision making. The Mexican Stock Exchanges (BMV and BIVA) launched an ESG disclosure project intended to help the listed companies consolidate all their sustainability disclosures to cater to different audiences (rating agencies, investor surveys, etc.). In 2020, the World Economic Forum (WEF) and the Aker Group in Norway established the Centre for the Fourth Revolution Norway (C4IR Norway) dedicated to harnessing digital innovation for a sustainable ocean economy. Switzerland aims to become a global hub for green digital finance and launched a green

⁴¹ On April, 21st 2021, the EU published a proposal [Corporate Sustainability Reporting Directive](#) (CSRD), an update to its non-financial reporting directive, issued in 2014. The new CSRD will apply to all large companies and all listed companies except micro-enterprises, increasing five-fold the number of firms that will produce their sustainability report to 55,000 by 2024. The proposal also introduces mandatory EU sustainability reporting standards covering all ESG topics under a double materiality principle (risks to companies and impacts of companies) and will be developed by the European Financial Reporting Advisory Group (EFRAG) EU standards should aim to incorporate the essential elements of globally accepted standards currently being developed. The CSRD also clarifies that EU standards should go further where necessary to meet the EU's own ambitions and be consistent with the EU's legal framework. In the accompanying materials and the recitals of the proposal, the European Commission expresses its support for global initiatives by the G20, the G7, the FSB and others to develop a baseline of global sustainability reporting standards, and explicitly cites the IFRS Foundation's ISSB initiative and the proposals of the alliance of leading sustainability reporting organisations that build on the work of the TCFD. The CSRD proposal also address the digitalization of sustainability information and simpler standards for SMEs under the principle of proportionality.



fintech action plan⁴² in April 2021. China is one of the countries with a large number of climate and environmental data sets harvested at facility levels as well as emissions data harvested by satellites. Japan has launched a Green Bond Issuance Promotion Platform as a step to leverage digital technology to make it easier for stakeholders to tap into the market. The European Union is currently establishing a regulation to digitalize all corporate sustainability reporting and is planning a European Single Access Point (ESAP), a digital platform which will gather all financial and sustainability information reported by European companies. A number of central banks and ESG data providers have designed algorithms for automated indexing of companies TCFD disclosure.

Under the Italian G20 Presidency, Banca d'Italia and the Bank for International Settlements (BIS) Innovation Hub have launched the international G20 TechSprint 2021 competition to highlight the potential of new technologies to resolve some of the most pressing challenges in green and sustainable finance, including in particular (i) data collection, verification and sharing, (ii) analysis and assessment of climate-related risks, including both physical and transition risks, and (iii) better connecting projects and investors.

2.3. Challenges in Sustainability Reporting and Disclosure

Despite the growing importance attributed to it by the financial community and regulators, challenges remain in the extent and quality of sustainability reporting by corporates. This section discusses the gaps existing between investor expectations and the reality of current corporate sustainability reporting, based on a recent stock-taking exercise by IOSCO. It also analyses three specific challenges, namely: pitfalls in current environmental disclosure frameworks (the “E” pillar of ESG), challenges in sustainability reporting by SMEs and challenges in the application of digital technology to sustainability reporting.

2.3.1. Gaps between Investor Expectations and Current Sustainability Reporting

Through stocktaking and engagement activities, the G20 SFWG has identified significant gaps and shortcomings in existing sustainability disclosures. This work was informed by

⁴² Green Fintech network (2021). Harnessing the Power of Digital Finance for Sustainable Financial Markets. https://backend.finance.swiss/download/26/2021_Green_Fintech_Action_Plan_final.pdf



two fact-finding exercises conducted by IOSCO to better understand the following questions:

- ***What sustainability information do investors seek to inform their investment decisions.*** As a proxy for investors' information needs, the stocktaking exercise engaged extensively with around 60 asset managers across 19 jurisdictions to determine how they use sustainability information provided by corporates and what information they consider to be useful for decision-making.
- ***Gaps and shortcomings in the information investors and other stakeholders currently receive from companies.*** The exercise carried out a detailed desktop analysis of corporate reports of a total of 90 companies, across 5 sectors and 6 jurisdictions⁴³, to gain insight into the current sustainability-related information they provide to investors.

The exercises highlighted a meaningful mismatch between the sustainability-related information required by asset managers and the sustainability-related information provided by companies, in particular in the following five areas:

- **Completeness, consistency and comparability of sustainability information.** Asset managers seek complete, consistent and comparable sustainability reporting to inform investment and risk analysis, while companies' sustainability disclosures are not complete, consistent and comparable.
- **Differences and choice of existing disclosure frameworks.** In the absence of a mandatory common international standard, asset managers see value in investee companies' reporting systematically against established frameworks. Where voluntary frameworks are used, many companies report selectively against multiple different voluntary frameworks and standards.
- **Topic scope and materiality.** Asset managers generally value investor-oriented, industry-specific information on all three ESG categories, especially from the decision-making perspective, while companies' sustainability-related disclosures typically aim to meet multiple stakeholders' needs (e.g., shareholders, government, suppliers, employees and customers) on core sustainability themes.
- **Qualitative vs quantitative disclosures.** Asset managers value a mix of qualitative information and quantitative metrics. Corporates do make both qualitative and quantitative disclosures, but the information is not consistent and quantitative metrics are limited.
- **The linkage between sustainability reporting and business strategies/financial implications.** Asset managers want to see the linkage

⁴³ Australia, China, European Union, Singapore, United Kingdom and United States.



between a company's sustainability risks and opportunities and its business, strategy and financials. But there is often a disconnect between companies' reported financial and sustainability performance, and inconsistency in location and timing of reports, as well as application of audit and assurance.

2.3.2. Challenges to SMEs' Sustainability Reporting

Small and medium-sized enterprises ("SMEs"), especially the smaller ones, classified as "micro" enterprises, face challenges in sustainability reporting that partially overlap with those faced by large companies but also present specific features. The International Chamber of Commerce (ICC) reviewed existing literature on corporate sustainability reporting, analysed existing reporting frameworks, and supplemented this research with data and insights from interviews with SMEs and local chambers of commerce across Europe, Asia-Pacific, North America and Latin America. This research identified several friction points and challenges to the widespread adoption of sustainability reporting by SMEs, which include:

- ***The proliferation of standards, frameworks and ESG tools.*** Most SMEs surveyed by ICC were not familiar with any specific reporting frameworks but were conscious of the proliferation of different standards and tools. In a number of cases, recent media reports on the fragmentation of the ESG metrics market influenced the view that sustainability reporting is a "corporate Public Relations (PR) exercise" for large multinational companies.
- ***The complexity of major reporting frameworks (such as Global Reporting Initiative (GRI)) relative to in-house SME resources.*** A small number of SMEs surveyed by ICC had looked at the GRI framework as a possible basis for producing sustainability reports. All considered the framework prohibitive relative to their internal resources and to the potential returns from issuing a first sustainability report. Commonly mentioned factors included: the complexity and a large number of reporting indicators; the likely cost of sourcing and processing data; the lack of dedicated or specialist in-house resources; and the lack of tailored training and support systems.
- ***Concerns that sustainability reporting, while voluntary, could still expose SMEs to legal and commercial risks.*** This concern seems to reflect recent legal trends such as (i) US securities regulations that could make companies liable for ESG disclosures that are deemed materially false or misleading;⁴⁴ and (ii) an

⁴⁴ David R. Woodcock, Amisha S. Kotte, and Jonathan D. Guynn (2019) "Managing Legal Risks from ESG Disclosures."



increase in class action lawsuits wherein consumers assert that they were misled into purchasing a product because of false and misleading statements made in sustainability reports.⁴⁵

- **No clear “business case” for SMEs to produce sustainability reports.** The only exception mentioned by SMEs was direct requests for disclosures from multinational corporation customers and service providers (e.g., banks and insurers). SMEs, however, indicated frustration at the number of disparate disclosure requests received from the latter.
- **No widely accepted training tailored to SMEs on developing a sustainability report.** In this respect, organizations such as the OECD and UN Environment Programme have recommended that sustainability language used in communications to small businesses be less technical and/or academic to drive greater adoption.⁴⁶
- **Limited uptake from competitors.** This is unsurprising since SME competitors are facing the same challenges.

2.3.3. Challenges in the Application of Digital Solutions to Sustainability Reporting

Digitization of sustainability-related information, such as ESG data flows, is a greater challenge than the digitization of financial accounting data because sustainability-related data tends to be in non-standardized formats, available from many different sources, processed with different methodologies, and often qualitative in nature.

Also, companies tend to under-leverage digital solutions for sustainability disclosures. Data collection has been, to a large degree, a handheld process with manual input into reporting software such as CDP and GRI, and in own corporate reports. The companies and data providers that have embraced technology are applying “first-generation” digital solutions that mainly leverage three data layers to create company ESG scores: (i) sentiment data about companies, where web-scraping technology is used to pick up red flags including traditional media and social media commentary; (ii) data about company behaviours available in public databases; and (iii) automated textual analysis of disclosure reports undertaken by algorithms.

⁴⁵ See e.g.: <https://www.lexology.com/library/detail.aspx?g=7c30ccf4-98cd-47fa-9bdf-dc77accb6e65>

⁴⁶ See e.g.: Beth Walker et al (2008) “Small and medium enterprises and the environment: Barriers, drivers, innovation and best practice: A review of the literature.”; OECD (2015) “Environmental Policy Toolkit for Greening SMEs in EU Eastern Partnership countries.”



Digital technology leveraged by these first-generation solutions is mainly based on Natural Language Processing (NLP) algorithms. NLP solutions are a popular approach to sustainability reporting because textual algorithms are cheap to design and are not dependent on the degree of digitization of the real economy. NLP solutions, however, also have significant flaws. In particular, they capture sentiment data that does not necessarily reflect real behaviours and therefore, may not offer accurate reflections of ESG risks and impacts; reliance on sentiment data may lead to greenwashing in sustainability reports, and ESG automated rating software is offered by non-regulated entities, algorithms are not audited, and data inputs are not verified.

Driven in part by the shift in disclosure requirements from company to business unit level, from qualitative to quantitative metrics and from climate-only to nature risks as well, a “second-generation” of digital solutions for sustainability reporting is starting to emerge. The biggest difference is that it integrates machine-harvested data directly from the real economy, leveraging the Internet of Things (IoT) and Earth Observation technologies (most notably satellite images). Company adoption of IoT for disclosure has mainly started with automatic harvesting of energy data either through own energy management software or via a service provider. Earth observation technologies offer companies access to machine-generated data for disclosure about both their nature-related as well as their physical climate risks.

Second-generation solutions can be particularly useful to address sustainability reporting gaps involving SMEs and nature-related risks. Rising demand for SME carbon data is driven by corporates moving to scope 3 emission accounting and by asset managers invested in banks with SME credit lines. Transaction costs of scope 1, 2 and 3 emissions data collection and analytics are too high if not automated for SMEs. Open banking infrastructure to facilitate access to SME transaction data coupled with the establishment of climate databases (either building on existing open-source databases or developing country-specific databases with carbon footprints of all products) can significantly improve the accuracy of automated SME carbon footprint reporting. With regards to nature-related risks, asset geolocation data – if made available – could be overlaid with existing biodiversity datasets (e.g., more than 250 biodiversity databases) by ESG data providers to develop new biodiversity data products and services that would allow companies and financial institutions to account for biodiversity material risks.



2.4. Recommendations

Improving the consistency, comparability and reliability of sustainability information available to investors and other participants in the world's capital markets helps to unlock their capacity to be informed about and react at scale to climate and other sustainability challenges. The G20, as the leading platform for international coordination, has a crucial role to play in supporting global efforts to advance work to integrate financial reporting and sustainability disclosure and explore the mechanisms to link this to broader global multi-stakeholder sustainability reporting.

In the July communiqué, Finance Ministers and Central Bank Governors welcomed the work towards developing a global baseline sustainability reporting standard developed under robust governance and public oversight. This global baseline should build upon the TCFD framework and work of other sustainability standard-setters and involve consultations with a wide range of stakeholders. There is a broad interest in expanding beyond climate to other sustainability topics such as, nature- and biodiversity-related information, with a particular focus on nature-based solutions or ecosystem-based approaches to climate change, and other social issues. In addition, some jurisdictions are exploring frameworks that integrate both the enterprise value approach of the IFRS Foundation and reporting on firms' impacts on sustainability goals that are not captured through the enterprise value lens.

The IFRS Foundation is working towards establishing an International Sustainability Standard Board (ISSB), from the enterprise value creation perspective, alongside the existing International Accounting Standard Board (IASB), leveraging its existing expertise and governance framework. The IFRS Foundation has concluded a consultation process on proposed constitutional amendments to give effect to the new board and is currently assessing the feedback received. At the same time, a Technical Readiness Working Group established by the IFRS Foundation Trustees is developing recommendations for the content of a 'climate first' standard to be delivered to the ISSB once established. G20 SFWG believes that the ISSB could play an important role in facilitating global consistency and comparability of sustainability reporting.

In their consideration of the IFRS Foundation's initiative, some SFWG members have expressed concerns over the transparency of the standard setting approach, the proposed governance structure, the scalability and proportionality of standards to accommodate jurisdictional differences, and the timeline for extending the topic scope of standards beyond climate change to also cover biodiversity, nature and other social and sustainability matters. IOSCO and the IFRS Foundation have provided additional clarifications to address these concerns (See Annex A).



As a response, the following recommendations have been developed after consultation with IOSCO and the IFRS Foundation and other relevant stakeholders, including investors and international organizations in the field of disclosure and reporting.

Recommendation 1: G20 to welcome the work program of the International Financial Reporting Standards (IFRS) Foundation. The IFRS Foundation work program, including its proposed International Sustainability Standards Board (ISSB), should be governed by a transparent and inclusive governance structure with public oversight provided by the Monitoring Board and a process of consulting a wide range of stakeholders. The ISSB would benefit from the IFRS Foundation three-tier governance structure. IOSCO has noted that its existing governance displays the key attributes of independence, public accountability and a rigorous, transparent, independent and participatory due process. The IFRS Foundation Trustees believe it has been working effectively – underpinning global market acceptance and public accountability. The Trustees are considering ways to facilitate inclusion of sustainability expertise and multi-stakeholder input in the proposed ISSB. The IFRS has provided additional detail on the proposed governance structure, attached as Annex [B].

Recommendation 2: The ISSB should develop a baseline global sustainability reporting standard while allowing flexibility for interoperability with national and regional requirements. This approach could provide a consistent, comparable, and reliable baseline of sustainability-related information that could be decision-useful to investors, while also providing flexibility for jurisdictions to consider gradual transition and coordination on reporting requirements that capture other sustainability interests and objectives or serve wider stakeholders in line with their domestic policy priorities. The IFRS Foundation proposes that the ISSB's future standards, sitting alongside financial reporting standards should be investor-oriented and with a focus on enterprise value creation, would form the first block, providing the global baseline. This baseline should build on current market best practices and on the work of existing international standards setter's initiatives and frameworks.

Recommendation 3: Start from climate and extend to other sustainability factors over time. The ISSB should take a 'climate first' approach in the near term, based on TCFD framework, in developing the reporting standards. However, once climate standards have been progressed, the ISSB should develop standards covering other sustainability topics, such as, nature- and biodiversity-related information, with a particular focus on nature-based solutions or ecosystem-based approaches to climate change, and other social issues.



Recommendation 4: Enhancing efforts on capacity building for SMEs and emerging markets. While the standards to be developed by the ISSB may be adopted by a broad range of jurisdictions around the world as a global baseline for reporting, SMEs and emerging markets could benefit from additional capacity-building initiatives. The IFRS Foundation could consider issuing sustainability reporting guidance for SMEs, similar to its [“IFRS for SMEs”](#) guidance dealing with accounting standards. The IFRS should cooperate with other sustainability standard-setters that are also working on SMEs disclosures. International organizations could promote the development and usage of digital technology solutions for sustainability reporting tailored for SMEs.

Note on Adopting and Implementing International Standards: At the request of the SFWG, IOSCO and the IFRS Foundation clarified that “the IFRS Foundation does not have the power to make the sustainability reporting standards mandatory. This power lies with the relevant and competent authorities in jurisdictions. In the case of reporting requirement for securities’ issuers, it is the discretion of the domestic securities regulators or the capital markets authorities to decide how to integrate the international standards into national or regional frameworks and to determine the disclosure requirements” (see Annex A).

Individual jurisdictions have different domestic arrangements for the adoption, application, or use of international standards. It will therefore be important for individual jurisdictions to consider how a common global baseline of sustainability standards could be adopted, applied or otherwise utilized within the context of these arrangements and wider legal and regulatory frameworks in a way that promotes consistent and comparable sustainability-related disclosures across jurisdictions.

IOSCO, as a membership organisation of the world’s securities regulators, has an essential role to play in evaluating the standards issued by the ISSB on issuers’ sustainability-related reporting requirements and plans to consider potential endorsement of future standards issued by the ISSB. After this endorsement, it is up to the securities regulators of individual jurisdictions to decide on whether, when and how to adopt such standards.



Enhancing the role of International Financial Institutions in supporting the goals of the Paris Agreement and 2030 Agenda

3.1. Background

International Financial Institutions (IFIs), including Multilateral Development Banks (MDBs), play a critical role in supporting the goals of the Paris Agreement and 2030 Agenda. In particular, MDBs should play a leading role in supporting the low greenhouse gas transition and in establishing climate-resilient development paths, as part of its broader operations to support delivering development goals in developing countries in accordance with the Paris Agreement⁴⁷. They do so through the alignment of their financial flows, policy advice, technical support, and capacity-building activities with the goals of the Paris Agreement first and also the 2030 Agenda, and through supporting the development of NDCs, and their translation into investment plans.

MDBs provide stable, long-term, and countercyclical lending at affordable rates. This is especially important for countries that have difficulty accessing affordable financing in private debt markets. In 2019, the MDBs committed USD 61.6 billion in climate finance, of which USD 41.5 billion or 67% of total MDB commitments was for low-income and middle-income economies.⁴⁸

Additionally, MDBs support climate action through the development of new financing instruments or frameworks that expand the pool of resources available for climate mitigation and adaptation efforts in accordance with countries NDCs and help catalyse investment from the private sector by creating conducive business environments through dialogues to improve the investment and regulatory environment. This is especially true in adaptation finance, where they can use a range of innovative financial instruments that blend new financial resources with traditional resources in order to close the financing gap for adaptation actions. Indeed, MDBs are the major providers of blended finance, accounting for 75% of the amounts mobilized in 2017-2018⁴⁹, and they also mitigate real

⁴⁷ Article 2.1c of the Paris Agreement stipulates “making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development” as one of the factors to strengthen the global response to the threat of climate change.

⁴⁸ Joint Report on Multilateral Development Banks Climate Finance, 2019

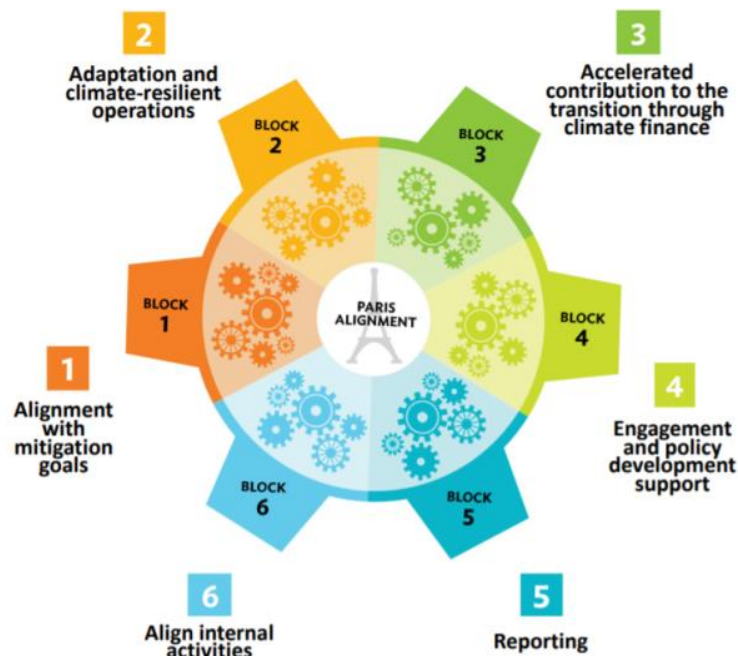
⁴⁹ Organisation for Economic Co-operation and Development (OECD), “Amounts Mobilised from the Private Sector by Official Development Finance Interventions in 2017-18, Highlights” (February 2020)



and perceived financial risks associated with development investments through credit enhancement, guarantees, and political risk insurance.⁵⁰ Ultimately, MDBs help uncover new opportunities for sustainable private sector investment as well as increase the stock of bankable projects through their support for project preparation, deal structuring, and capacity building.

This chapter will look into the role played by MDBs to support the goals of the Paris Agreement and the 2030 Agenda, while recognizing the need to maintain their focus on core mandates and ensure financing availability and accessibility for country-specific developmental goals, and noting it is important that national development and credit guarantee schemes take explicitly into account sustainability issues (e.g., those included in 2030 Agenda and the Paris Agreement).

Figure 4: Six building blocks and principles jointly agreed by the MDBs as core areas for aligning with the Paris Agreement



Source: MDB Paris Alignment Working Group (2019) Institutions Initiative – 6 June 2019 – PowerPoint presentation.

⁵⁰ Global Partnership for Effective Development Co-operation (GDEP MDB), “Multilateral Development Banks and Private Sector Engagement for Sustainable Development” (July 2019).



The chapter will identify the challenges and gaps that remain and make recommendations on how to enhance the role of MDBs in supporting global sustainable development, with an emphasis in the climate agenda. The chapter will start with an overview of the commitments made so far by MDBs towards the Paris Agreement and the expected timeline for such commitments. It will then analyse the MDBs building-block approach to Paris Alignment, with a focus on the steps taken thus far in each of the six building blocks. The chapter will go on to discuss the challenges of operationalizing the alignment of operations. Finally, the chapter will provide a set of recommendations for expanding the role of MDBs in providing and catalysing private sector financing for climate actions, especially in emerging markets and developing economies.

3.2 Commitments by MDBs towards the Paris Agreement

During the 2015 Conference of Parties (COP21)⁵¹, a number of MDBs announced their commitment to work collaboratively to significantly increase climate investments from both the public and private sectors to support countries' efforts. The COP21 MDBs Joint Statement also emphasized their support of the voluntary Principles for Mainstreaming Climate Action within Financial Institutions, as a guide to their climate-smart development priorities.

In the One Planet Summit in 2017, MDBs alongside the International Development Finance Club (IDFC) subsequently made a pledge to align their financial flows with the objectives of the Paris Agreement.⁵² This pledge followed from the MDBs and IDFC recognition of the role they play in directing capital towards sustainable investments by demonstrating the opportunities and potential returns, as well as by reducing the risks associated with them. They also committed to using their ability to mainstream sustainable development and climate agendas across all sectors, in accordance with their mandates.

After announcing their vision to align financial flows with the Paris Agreement, the MDBs developed their dedicated six-building-block (Figure 4) approach to the operationalization of the Paris Agreement Article 2.1c during the Conference of Parties (COP21)⁵³.

⁵¹ https://www.eib.org/attachments/press/joint-mdb-statement-climate_nov-28_final.pdf

⁵² <https://www.worldbank.org/en/news/statement/2017/12/12/together-major-development-finance-institutions-align-financial-flows-with-the-paris-agreement>

⁵³ <https://thedocs.worldbank.org/en/doc/784141543806348331-0020022018/original/JointDeclarationMDBsAlignmentApproachtoParisAgreementCOP24Final.pdf>



A joint MDB working group, the Paris Alignment Working Group renamed to MDB Climate Working Group, consisting of the nine largest MDBs, is developing methods and tools to operationalize each of the Building Blocks and aims to have this work completed and operational by 2023–24 (Figure 5). Currently, MDBs are in the process of road testing and piloting the methodologies for direct investments to enhance the transparency and comparability of their implementation across MDBs, and to enable other development partners to deploy, while also working on the development of methodologies for intermediated finance and policy-based operations.

Figure 5: MDBs Timeline to Align with Paris Agreement

2020-2021	2021-2022	2022-2023	2023-2024	Throughout
Development and road-testing of methodologies for direct operations	Development and road-testing of methodologies for intermediated finance and policy-based operations	- Piloting and optimization phase - Improve transparency and comparability of implementation	Implementation based on individual MDB timelines*	Continued support on policy levers and climate finance mobilization

*For EIB by end of 2020

Source: Joint MDB presentation to the 2cd SFWG meeting, 18 June 2021.

In the UN 2019 Climate Action Summit, the MDBs committed to helping their clients deliver on the goals of the Paris Agreement.⁵⁴ The MDBs further committed to help clients move away from the use of fossil fuels while supporting a Just Transition that promotes economic diversification and social inclusion. Working towards their Just Transition commitment, the MDBs have developed Just Transition Principles based on a 2020 stock-take that aimed to assess the level of understanding of what this entails, and to identify the practical means through which MDBs can support a Just Transition while learning from past experiences.

3.3 MDBs building-block approach to Paris Alignment

Along with the private financial sector, MDBs are developing the methods and metrics to assess Paris-aligned finance flows. Sound methods and metrics that can measure, report, and inform investment decisions are an integral factor in progressing the

⁵⁴ <https://www.adb.org/sites/default/files/page/411117/climate-change-finance-joint-mdb-statement-2019-09-23.pdf>



strategic framework for Paris alignment.⁵⁵ To that end, the emerging MDB Building Block approach – involving six building blocks – form the core for alignment with the objectives of the Paris Agreement and as the basis for driving the required economy-wide transition in developing countries.

3.3.1. Building Block 1 (BB1): Alignment with mitigation goals

MDBs' operations should be consistent with the varying countries' low GHG emission development pathways, as well as compatible with the overall climate change mitigation objectives of the Paris Agreement. Building upon Principle 2 of the “Mainstreaming Principles”⁵⁶ which focuses on “Managing climate risk”, MDBs commit to assessing their operations against transition risks and opportunities arising from the process of climate transition.

MDBs have developed joint climate mitigation methodology for direct operations.

The methodology is designed to classify operations on a project-by-project basis, looking at their emissions profiles. Projects are classified as corresponding to a jointly agreed-on positive list of project types that are considered universally aligned with the mitigation goals of the Paris Agreement in all contexts, or to a negative list of projects that are universally not aligned. All other projects are assessed based on a multi-criteria approach that takes into account the following five specific criteria: NDC consistency, consistency with the country Long Term Strategies, consistency with the global long-term pathways of the Paris Agreement, a no regrets tests and an economic analysis test.⁵⁷ **MDBs also use the assessment process to help identify opportunities** to work with the client on developing a low GHG, resilient climate strategy.

Evaluation of the methodology has pointed to the urgency to develop and publish its details. MDBs have not yet disclosed the positive or negative lists. Additionally, the details of the specific assessment criteria are yet to be disclosed. MDBs have also not provided an explanation of how they will consider the local country contexts and

⁵⁵ Rydge J (2020) Aligning finance with the Paris Agreement: An overview of concepts, approaches, progress and necessary action. London: Grantham Research Institute on Climate Change and the Environment and Centre for Climate Change Economics and Policy, London School of Economics and Political Science.

⁵⁶ https://www.afdb.org/fileadmin/uploads/afdb/Documents/Events/COP21/Mainstreaming_climate_action_within_financial_institutions_-_Five_Voluntary_Principles.pdf

⁵⁷ Rydge J (2020) Aligning finance with the Paris Agreement: An overview of concepts, approaches, progress and necessary action. London: Grantham Research Institute on Climate Change and the Environment and Centre for Climate Change Economics and Policy, London School of Economics and Political Science.



circumstances, and what sector-specific standards they will apply. The MDBs are likely to adopt a conservative approach in applying the specific assessment criteria.

3.3.2. Building Block 2 (BB2): Adaptation and climate-resilient operations

MDBs commit to actively managing physical climate change risks and identify opportunities to make their operations more climate resilient. They seek to support an increase in their clients' communities' ability to adapt to the adverse impacts of climate change.

MDBs have developed a joint adaptation and climate-resilient methodology for direct lending. The methodology is context-specific and process-based. It builds on a three-level assessment framework. **Level 1** identifies and assesses physical climate risks, to establish climate risk and vulnerability context. If yes, the method moves to **Level 2** which focuses on climate resilience measures to limit the risk exposure or build climate resilience. **Level 3** looks if the operation is consistent with the national policies for climate resilience. If the answer to either level 2 or 3 is “no”, the project is not Paris-aligned.⁵⁸

The adaptation and climate-resilient methodology for direct operations is aligned with joint-MDB adaptation finance tracking methodology, and consistent with the recent developments in the EU Taxonomy and Climate Bonds Initiative.

A project needs to be “aligned” with regards to BB1 and BB2 to be considered aligned with the Paris Agreement. This is in line with the Paris Agreement, where the concept of alignment focuses on the consistency of operations with the countries' low-GHG, climate-resilient development pathways and compatibility with the overall climate mitigation and adaptation objectives of the Paris Agreement.

The assessment under BB1 and BB2 is based on the information, data, and assessment tools available and designed to account for uncertainty and evolving technology and development scenarios. The joint methodology for direct operations is being road-tested and is starting to be piloted by the MDBs for implementation.

3.3.3. Building Block 3 (BB3): Accelerated contribution to the transition through climate finance

MDBs commit to scaling up climate finance, operationalize new approaches to support NDCs and accelerate the realization of United Nations Framework Convention on Climate Change (UNFCCC) climate ambitions in line with science-based evidence. This involves going beyond current efforts to (i) prioritize, target and report on climate finance, (ii)

⁵⁸ Ibid.



mobilize private sector investments, (iii) support clients' access to concessional finance, and (iv) provide the technical assistance for climate action.

Following this commitment, the MDBs further announced, at the margins of the UN 2019 Climate Action Summit, that they would collectively raise USD 65 billion annually by 2025 in climate finance, with \$50 billion for low- and middle-income economies. Within these efforts, they intend to double the total level of adaptation finance to USD 18 billion annually. Additionally, MDBs aim to mobilize an additional USD 40 billions of climate investments annually from private sector investors, through increased provision of technical assistance, use of guarantees, and other de-risking instruments.

In 2020, the MDBs committed USD 66 billion in climate finance, up from USD 61.6 billion in 2019. Mitigation finance reached USD 49,945 million constituting 76% of the total, while adaptation finance reached USD 16,100 million or 24% of the total. In 2020, USD 38,009 million or 58% of total MDB commitments was for low-income and middle-income economies.⁵⁹

MDBs support country access to international climate funds. As accredited entities to multiple trust funds such as the Green Climate Fund, the Climate Investment Funds, the Global Environment Facility and the Adaptation Fund, MDBs implement climate projects on behalf of countries of operations. For instance, five MDBs have accessed USD 3.3 billion for 41 projects since the inception of the Green Climate Fund in 2010. Similarly, since the inception of the Climate Investment Funds (CIF) in 2008, six MDBs have deployed USD 7.5 billion of CIF funding in conjunction with their own finance for projects.

They are also working on supporting market and non-market approaches in accordance with Article 6 of the Paris Agreement. MDBs are engaged in piloting both market and non-market approaches as a means to mobilize resources for mitigation and adaptation activities. These mechanisms allow for the valorisation and/or monetization which underpins further mobilization of climate finance, specifically for the private sector. Specific areas of activity include the Climate Markets Club⁶⁰, the Adaptation Benefits Mechanism⁶¹ along pilot projects.

⁵⁹ Joint Report on Multilateral Development Banks Climate Finance, 2020

⁶⁰ <https://www.worldbank.org/en/programs/climate-warehouse/overview>

⁶¹ <https://www.afdb.org/en/topics-and-sectors/initiatives-partnerships/adaptation-benefit-mechanism-abm>



3.3.4. Building Block 4 (BB4): Strategy, Engagement and Policy Development

MDBs seek to build on their existing efforts to support the NDC revision cycle and clients' development of long-term strategies for accelerating the transition to low-emissions and climate-resilient development pathways. MDBs provided support along with the NDC and long-term low greenhouse gas emission development strategies cycle for 96 countries, growing the 2019 coverage by more than 50%. 69 MDB engagements have occurred in 39 countries to help develop their LTS.

MDBs are working on a new joint Long-Term Strategies Initiative to be implemented over the next four years. The initiative aims at supporting countries in the preparation and implementation of long-term low GHG and climate-resilient development strategies. These strategies provide context to NDCs, act as investment signals to the private sector, and are crucially linked to a country's long-term development aspirations. The Initiative incorporates the following key elements: development of common principles for Long-Term Strategies, support for in-country work related to LTS development, and dissemination of knowledge and progress about LTS through a knowledge platform, workshops, and training.

In accordance with the Just Transition imperative of the Paris Agreement and their commitment to the ideal, MDBs are developing a set of common principles for MDBs support for Just Transition. MDB Just Transition support is expected to:

- **Deliver on climate objectives** specified under the Paris Agreement, while enabling socioeconomic outcomes.
- **Focus on aiding the move away from high GHG emission-intensive economies.**
- **Target helping delivers long-term, structural economic transformation** through the mobilization of resources and enhanced coordination on strategic planning.
- **Mitigate negative socioeconomic effects** and boost opportunities associated with the transition to a low GHG economy; and
- **Encourage transparent and inclusive planning, implementation, and monitoring processes.**

3.3.5. Building Block 5 (BB5): Reporting

Extending their joint efforts on climate finance tracking, MDBs will further develop tools and metrics for characterizing, monitoring, and reporting on the impacts of their Paris Agreement activities.



MDBs have worked on developing a reporting format and have been collaborating to identify metrics linked to the Paris Agreement efforts across the six building blocks. MDBs and the IDFC are currently developing additional metrics to identify and report on climate resilience in their development operations. Discussions on outcome metrics (BB1 and BB2) and reporting on policy-related activities (BB3 and BB4), as well as reporting on MDBs' internal activities alignment (BB6) have taken place.

3.3.6. Building Block 6 (BB6): Align Internal activities

MDBs commit to progressively ensure that their internal operations, including internal policies as well as facilities, are also in accordance with the objectives of the Paris Agreement.

MDBs have developed a draft guidance note on BB6 and it provides guidance on good practice. It is being discussed among the MDBs.

3.4 Challenges

While MDBs have made good progress, there remains a huge gap between the scope of their climate work programs and the scale and speed required to achieve the SDGs and goals of the Paris Agreement. Amid rising awareness of the need to step up efforts in addressing climate change, there are increasingly strong calls from political leaders and experts for the MDBs to scale up and accelerate their ongoing work in this area. These include, for example, enhancing the climate-related financing commitments, stronger engagement with governments in emerging markets and developing countries to increase the supply of bankable green projects, and better support for quality NDCs through financing and capacity assistance.

3.4.1. Embedding adaptation and resilience into MDB climate engagement with public and private clients is critical

The 2020 Joint Report on MDB Climate Finance indicates that, out of the USD 66.045 billion committed by MDBs to climate finance in the reporting year, 76% (USD49.945 billion) were allocated to mitigation finance, while only 24% or USD 16.1 billion went to adaptation. Also, the same report shows that almost 76.5% of total climate finance (USD 50.477 billion) was committed through investment loans, while commitments through other financing instruments such as policy-based lending, grants, guarantees, and other



lines of credit only accounted for an extremely limited portion of the total commitment⁶². Greater focus on adaptation finance, along with a larger variety of financing instruments used by MDBs to commit overall climate finance, would seem pertinent.

3.4.2. There is a need to strengthen MDBs' capacity to better leverage private sector resources

OECD data shows that, over the period from 2012 to 2018, USD 205.2 billion was mobilized from the private sector by development finance interventions, which cover guarantees, syndicated loans, shares in collective investment vehicles (CIVs), credit lines, direct investment in companies and project finance special purpose vehicles (SPVs), and simple co-financing arrangements. This amount needs to grow significantly to help close the estimated financing gap of USD 2.5-3 trillion per year to achieve the SDGs in developing countries. There is a need to look further at how the MDBs can de-risk private capital in adaptation and mitigation and what measures they can take to promote green capital markets and investment practices globally.

3.4.3. There is a need for the MDBs to help scale up and expand green and sustainable finance frameworks in developing countries

Developing countries seeking to expand green finance domestically will need more support from MDBs to establish the needed eco-system for sustainable finance, including, depending on country needs, developing the financial policy and regulatory framework such as taxonomies and disclosure requirements, as well as policy incentives, and product innovations. Policy advice, technical support, and capacity building are an essential part of MDBs' activities in supporting the low emission transition in developing countries, where the need for assistance in building policy frameworks and domestic capacities to support the goals of the Paris Agreement and the 2030 Agenda is significant. Good progress has been made, notably by research institutions, in helping developing countries such as Mongolia and the Philippines put in place underlying policies such as green taxonomies. More efforts are needed on the part of MDBs in advising and financing developing countries to establish the needed eco-system for sustainable finance, including financial policy and regulatory framework (e.g., taxonomies, disclosure requirements), policy incentives, and product innovations.

⁶² 2020 Joint Report on Multilateral Development Banks' Climate Finance, June 2021. Available at: <https://reliefweb.int/sites/reliefweb.int/files/resources/2020-Joint-MDB-report-on-climate-finance-Report-final-web.pdf>



3.5 Recommendations

Many emerging and developing economies are dominated by traditional carbon-intensive activities and technologies and face significant transition risks. However, their current green and sustainable financing framework is not well designed to support the financial needs of carbon-intensive companies aimed to transform themselves to lower carbon operations. The MDBs could play a more constructive role in developing a financing climate transition framework in emerging markets and developing countries, helping the sectors and segments of population who are particularly vulnerable to cope with the transition.

Recommendation 1: MDBs should raise their ambition in financing climate actions

MDBs should work with clients to ensure that adaptation and resilience are embedded in investments and policies. Adaptation finance should be increased and prioritized in country contexts where urgent adaptation to climate change is required. Similarly, more attention could be paid to increasingly diversify the type of financing instruments used for climate finance, with a view to achieving a more balanced mix between investments loans and other instruments. These include grants, policy-based lending, guarantees, and other lines of credit, based on national circumstances and taking into account the fiscal space available to each developing country client.

Recommendation 2: MDBs should scale up their de-risking facilities for crowding in private sector finance

MDBs are encouraged to use financial and non-financial tools to help governments and the private sector overcome real and perceived risks and other barriers to climate investment. MDBs can support efforts to increase private sector finance through the employment of an extensive range of innovative financial instruments that blend new financial resources with traditional resources to finance climate actions. Such instruments should aim, among other things, at lowering risks for private sector actors contemplating climate finance investments in developing countries, as well as creating/enhancing a regulatory environment that can successfully attract private finance.

Recommendation 3: MDBs should step up efforts to support developing countries in developing policy frameworks for sustainable finance

Greening the domestic financial systems in emerging and developing economies is critical for long-term sustainable investment. MDBs, working with others, can play a critical role in disseminating knowledge, building technical capacity, helping develop the policy and



regulatory framework such as taxonomies and disclosure requirements, assisting in product innovation by local financial institutions, and nature-based solutions or ecosystem-based approaches.

Recommendation 4: MDBs should enhance engagement with countries on NDCs and LTS development and implementation

MDBs need to coordinate their in-country support, which is key to effective LTS development to maximize the impact of MDB on the Paris Alignment at the country level. MDBs, in partnership with others working on NDCs, could support countries in developing tools and innovations that can improve the NDC's ecosystems (NDCs and supporting frameworks for implementation)⁶³, and targets translating NDCs into bankable projects that are able to attract private international and domestic finance. MDBs could provide support in developing climate finance strategies to complement country LTSs/NDCs implementation roadmaps.⁶⁴

Recommendation 5: MDBs should devote resources to financing the climate transition

MDBs could play a key role in help emerging markets and developing economies in establishing a framework for financing the climate transition -- including technical pathways, disclosure requirements, de-risking facilities and financing products -- by initiating demonstration projects in key sectors such as energy, transportation and heavy manufacturing. For example, MDBs can help identify appropriate coal-fired power generation companies and assist and accelerate their transformation towards renewable producers with innovative finance schemes. MDBs can also develop measurement of social impact of transition activities and ensure MDB-supported transition projects take into account social implications such as employment.

⁶³ United Nations Environment Programme (UNEP), "Aligning climate finance to the effective implementation of NDCs and to LTSs" (2018).

⁶⁴ Ibid



Annex 1 - Q&A on IFRS Foundation’s project on sustainability-related financial disclosure standards (provided by IFRS Foundation) ⁶⁵

1. How will the IFRS Foundation ensure legitimate governance and oversight of the proposed ISSB?

A three-tier approach: the Foundation’s existing three-tier structure (see Figure 1 overleaf) is proposed to ensure adequacy and legitimacy of governance and oversight for the ISSB: (i) public authorities are represented on the Monitoring Board, which provides a direct link to governments, (ii) the Trustees provide robust independent oversight, and (iii) the Board members provide independent standard-setting expertise. In response to the Foundation’s consultation paper (2020), stakeholders acknowledged that the ISSB would benefit from this structure.

Transparency, full and fair consultation, and accountability given the IFRS Foundation’s existing mission to develop standards that “bring transparency, accountability and efficiency to financial markets around the world”, the Trustees propose that the new board replicate the due process principles of the IASB, which have received wide-spread endorsement in achieving global consistency in financial reporting. These include principles of transparency, full and fair consultation, and accountability. Full and fair consultation processes include research, agenda-setting, transitional arrangements, post-implementation reviews and interpretations, all subject to public consultation.

Transparency is enhanced through the Board’s public deliberations. For the ISSB, IOSCO and the IFRS Foundation are exploring the establishment of a consultative committee, within the IFRS Foundation structure, to facilitate discussion on jurisdiction-specific approaches to companies’ broader sustainability reporting requirements, where these are not otherwise captured by the ISSB’s enterprise value-oriented standards. Such a transparent discourse about sustainability issues would foster a two-way dialogue between standard setters, with a view to supporting interoperability between the ISSB’s global baseline and additional jurisdiction-specific reporting requirements.

⁶⁵ This annex is provided by IFRS Foundation as a response to G20 SFWG request.



2. Will the ISSB move beyond the topic of climate in its standard-setting?

The ISSB is proposed to prioritise climate-related disclosure but move quickly to meet the information needs of investors across other environmental, social and governance (ESG) matters. This commitment has been further enhanced by the Trustees providing power to the Chair and Vice-Chair of the new board to undertake an agenda consultation as soon as they are in place, which would consult interested stakeholders on other sustainability-related disclosures for capital markets that the ISSB should address in its early standard-setting.

3. Will the standards have a degree of flexibility to enable gradual transition at the discretion of jurisdictions?

IOSCO has included in its recent report an explanation that standards issued by an ISSB can be developed and adopted in a proportionate way, which acknowledges the different profiles and capabilities of reporting companies across jurisdictions. For instance, more proportionate adoption may be necessary in the case of smaller issuers, or issuers in emerging economies (see further below regarding SMEs). The IFRS Foundation does not have the power to make standards mandatory. This power lies with the relevant and competent authorities in jurisdictions. In many cases, it is at the discretion of domestic securities regulators or capital markets authorities to decide how to integrate the standards into national or regional frameworks and to determine the disclosure requirements – hence the relevance of IOSCO’s endorsement, which would encourage jurisdictions’ requirements to take from ISSB standards. The IFRS Foundation, through the IASB’s IFRS Standards, have considerable experience in supporting stakeholders to transition toward the adoption of IFRS Standards and to assist global stakeholders in the consistent application of those standards. The Trustees intend for the ISSB to learn from that experience.

4. How will emerging market needs be considered as part of a global baseline approach?

The involvement of emerging markets is a key element of the proposed approach to establishing a global baseline as part of a building blocks approach. The IFRS Foundation has established mechanisms for the involvement of emerging economies in the standard-setting process of the IASB. Specifically, an emerging economies group forms one of the IASB’s technical consultative committees, ensuring that emerging economies are specifically consulted in the development of IFRS Standards. The Trustees are determining the target operating model for the ISSB to ensure the involvement of emerging economies in the development of IFRS Sustainability Standards. The IOSCO



Growth and Emerging Markets (GEM) also sits on the Monitoring Board of the IFRS Foundation.

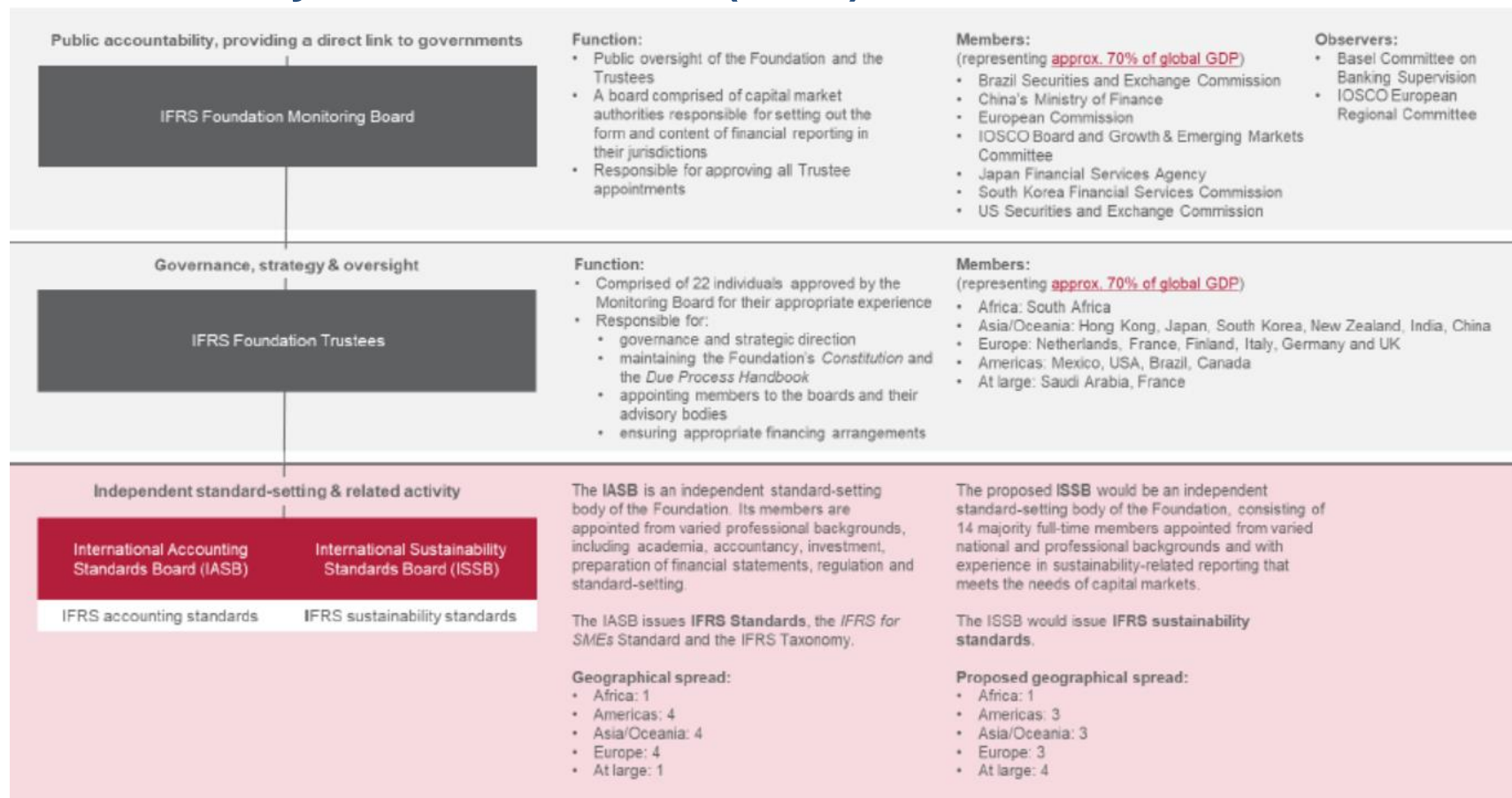
5. How will the Foundation build the capacity of emerging markets and SMEs?

The IFRS Foundation will continue to work toward building capacity in emerging markets and with Small and Medium-Sized Entities (SMEs) to further develop the understanding of its standards and standard-setting process. The importance of this for the ISSB is publicly acknowledged by the Trustees in their Feedback Statement (April 2021).

For the IASB, this focus forms part of a memorandum of understanding between the IFRS Foundation and the World Bank Group. The IASB also develops an IFRS for SMEs Standard which is a simplified set of IFRS Standards designed to meet the needs of SMEs that do not have public accountability.



Annex 2 - Proposed governance structure for an International Sustainability Standards Board (ISSB) under the IFRS Foundation





List of Acronyms

ACMF	Association of Southeast Asian Nations Capital Market Forum
AP4	Fourth Swedish National Pension Fund
ASEAN	Association of Southeast Asian Nations
BB1	Building Block 1
BB2	Building Block 2
BB3	Building Block 3
BB4	Building Block 4
BB5	Building Block 5
BB6	Building Block 6
BIS	Bank for International Settlements
BNPP	Banque Nationale de Paris Paribas
C4IR	Centre for the Fourth Revolution Norway
CBI	Climate Bond Initiative
CBS	Climate Bonds Standards
CDP	Carbon Disclosure Project
CIF	Climate Investment Funds
CIV	Collective Investment Vehicle
COP	Conference of Parties
COP21	21st Conference of Parties in 2015
CSR	Corporate Social Responsibility
CUFE	Central University of Finance and Economics
UN-DESA	United Nations Department of Economic and Social Affairs
DJSI	Dow Jones Sustainability Indices
DNSH	Do No Significant Harm
ESAP	European Single Access Point
ESG	Environmental, Social and Governance
EU	European Union
UNEP-FI	United Nations Environment Programme Finance Initiative
FSB	Financial Stability Board
GBP	Green Bond Principles
GEM	Growth and Emerging Markets
GHG	Greenhouse Gas



GISD	Global Investors for Sustainable Development Alliance
GRI	Global Reporting Initiative
IASB	International Accounting Standard Board
ICC	International Chamber of Commerce
ICMA	International Capital Market Association
IDFC	International Development Finance Club
IFI	International Financial Institution
IFRS	International Financial Reporting Standards
IOSCO	International Organization of Securities Commissions
IPSF	International Platform on Sustainable Finance
ISIC	International Standard Industrial Classification
ISSB	International Sustainability Standards Board
ITR	Implied temperature rise
LTS	Long-Term low greenhouse gas emission development Strategies
MDB	Multilateral Development Bank
NACE	Statistical Classification of Economic Activities in the European Community
NDC	Nationally Determined Contributions
NGFS	Network for Greening the Financial System
NLP	Natural Language Processing
OECD	Organisation for Economic Co-operation and Development
PE	Private Equite
PIMCO	Pacific Investment Management
PR	Public Relations
SBP	Social Bond Principles
SDG	Sustainable Development Goal
SDI	Sustainable Development Investing
SFSG	Sustainable Finance Study Group
SFWG	Sustainable Finance Working Group
SIC	Standard Industrial
SME	Small and Medium-Sized Enterprises
SPV	Special Purpose Vehicles
SRI	Socially Responsible Investing
STF	Sustainable Finance Taskforce
TCFD	Taskforce on Climate-related Financial Disclosures
TSC	Technical Screening Criterion
UK	United Kingdom



UN	United Nations
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme
UNFCCC	United Nations Framework Convention on Climate Change
US	United States
USD	United States Dollar
WEF	World Economic Forum