Sustainable investment: regulatory priorities
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Sustainable finance is now at the top of the global regulatory agenda for central banks as well as regulators of securities markets. This is especially the case for climate finance, recognising both the considerable opportunities and the challenges in this complex area.

Two years ago, the International Organization of Securities Commissions (IOSCO), whose board I Chair, published its first major report on the role of securities regulators in sustainable finance. The report identified three main areas of concern.

First, the existence of multiple, mainly private-sector sustainability standards—what is sometimes referred to as the "alphabet soup"; second, a lack of common definitions for sustainable activities; and third, mounting concerns about greenwashing.

It was absolutely clear that there was an urgent need to improve the consistency, comparability and reliability of sustainability reporting, especially at the corporate level. The availability of credible real-economy data is absolutely essential to all investment activity which attempts to take account of sustainability issues.

A global standard for corporate sustainability reporting

An important aspect of IOSCO's work since 2020 has been to support and engage with the efforts of the IFRS Foundation to develop a common set of global corporate sustainability reporting standards.

The IFRS Foundation's new International Sustainability Standards Board (ISSB) was announced at COP26, the United Nations Climate Change Conference, last November.

Sitting alongside the well-established International Accounting Standards Board, the ISSB aims to set a global baseline for jurisdictions to use when setting or implementing their own sustainability reporting requirements.

The ISSB is now consulting the public on its first set of proposed standards for general sustainability and climate disclosures.

In parallel, IOSCO is conducting a thorough review of these proposals based on criteria set out by its corporate reporting workstream in 2021. This review will help IOSCO decide whether to formally endorse the standards to its members, as it did 20 years ago in relation to the IFRS Foundation's accounting standards. That endorsement was a major reason why those are the accepted accounting standards in force across much of the world.

Note: This is the text of the speech as drafted, which may differ from the delivered version.

IOSCO will pay close attention to some key tests when deciding whether to endorse the ISSB standards. Naturally, the standards will need to meet investors' core information needs and also enable financial markets to more accurately price sustainability risks and opportunities.

Crucially, they will also have to solve the "alphabet soup" problem of too many inconsistent or competing standards, which is a sure-fire way for greenwashing to undermine the whole sustainable finance effort.

In this respect, the consolidation of existing standard-setters such as the Climate Disclosure Standards Board and Value Reporting Foundation into the ISSB sends a hugely important message that the ISSB standards should not be seen as just another set amongst many other global standards.

Next is market acceptance. It is imperative that the standards command sufficient acceptance to serve as a global baseline for consistent and comparable approaches across jurisdictions.

They also need to be interoperable with regional or jurisdiction-specific requirements and form the basis for the development of a sound audit and assurance framework. These two tests are fundamental.

To ensure that the standards are developed in a way that works in the public interest, IOSCO also chairs the IFRS Foundation Monitoring Board which includes securities regulators and other public authorities.

If the IOSCO Board endorses the final ISSB standards, hopefully by the end of the year, this will provide the more than 130 IOSCO member jurisdictions with a strong signal to consider how they might adopt them domestically.

Jurisdictional interoperability

I would like to focus in on the two fundamental tests I just mentioned.

The first is interoperability with jurisdiction-level standards now in development. This is a complex topic. In essence, it means that the ISSB standards must be compatible with detailed proposals emerging in a few advanced economies, whilst ensuring that they also work to accelerate corporate sustainability reporting across other economies, especially in the developing world.

It is essential that the international standards are designed in such a way that they can be applied in a flexible and scalable way across different jurisdictions.

Two domestic proposals for corporate climate reporting are especially significant: the US Securities and Exchange Commission's climate disclosure proposal and the exposure drafts for the EFRAG[1] sustainability reporting standards. Both are now out for consultation.

The last thing we want to see is a situation where there are three competing, incompatible standards—from the US, the European Union (EU) and the ISSB. That would risk defeating the main goal, which is to achieve compatible and comparable corporate reporting on a global level.

[1] European Financial Reporting Advisory Group.

The need for interoperability is especially crucial because international standards are not just concerned with investment in the US and the EU, and we are not solely concerned with how the standards could affect companies exporting into the EU or listed in New York.

The fact is that Asia contributes half of the world's carbon emissions, and so it is essential that corporate reporting of climate-related risks and opportunities in Asia, and in developing economies elsewhere, are adequate to properly inform providers of capital in this part of the world.

Interoperability will therefore be important to ensure that as many jurisdictions as possible are on board with the new standards.

The good news is that the EU and US are both fully aware of this issue and show every sign of engaging to ensure that jurisdiction-level standards are interoperable with each other as well as with the emerging global baseline.

Also taking place is a very important discussion about the proportional and scalable implementation of ISSB standards, particularly for smaller companies and those developing countries which need to address critical challenges around data availability and data interpretation.

Assurance

The second key criteria for IOSCO is assurance. To instil trust in the quality of sustainability disclosures, independent assurance will be essential.

There are obvious challenges. Assurance opinions for sustainability information will be based on very different methodologies compared to a conventional audit.

Some of the data to be reviewed will be external to the company, which may have little influence over its validity and availability; for example, information about Scope 3 emissions, the indirect emissions which occur in a company's value chain. This contrasts with the information used to construct traditional financial statements, which is largely sourced from internally generated data.

In many cases, the forward-looking analyses or estimates in sustainability disclosures, such as warning scenarios, will be far more uncertain than the disclosures we are used to seeing in traditional financial statements.

Another big challenge is determining measures of materiality and how issues which are assessed to be material in sustainability reporting have an impact on traditional financial statements and audits.

Nonetheless, it is important to investors that companies connect these metrics with conventional financial information, such as capital expenditure for emissions reduction or purchases of carbon offsets to hit net zero targets. This is a new area where more explicit guidance will be needed.

In my view, auditors and chief financial officers need to start paying far more attention to the relevance of sustainability disclosures to financial statements, because investors look first at hard numbers over and above qualitative disclosures. This is a key reason why IOSCO favoured the establishment of the ISSB within an IFRS Foundation framework, which already houses global accounting standards.

I would also like to briefly mention two other current IOSCO priorities.

The first relates to the expected rapid growth of carbon markets. We are looking at whether, from a regulatory perspective, these can be integrated into the global financial market infrastructure. IOSCO will also carry out a review to identify vulnerabilities in voluntary carbon markets, which have been a particular focus of greenwashing concerns.

Another priority is to engage with national regulators and market participants to encourage them to implement IOSCO's existing recommendations for asset managers to address greenwashing risks, as well as its recommendations for the providers of ESG[2] ratings and data, who are set to play a significantly larger role.

Implementation in Hong Kong

Before I conclude, I would like to say a few words about our approach to sustainability reporting in Hong Kong.

As a priority, the SFC is evaluating a climate-first approach to implementing the ISSB standards for Hong Kong listed companies.

A large proportion of these are Mainland companies and many of them have a very large operational footprint on the Mainland. It is essential to ensure that we implement these standards in a manner which is proportional and practical for these companies and properly synchronises with the Mainland's domestic industry standards and regulations, which continue to develop.

Obviously, we cannot reasonably expect companies to meet all of the ISSB climate standards on day one. Companies in some industries will need to do more to comply, in particular when it comes to data collection and sustainability reporting on their Mainland operations. Some may face challenges due to a lack of information from their supply chains or inconsistencies in local standards.

To ensure the reliability of the information disclosed, more technical expertise will be needed within companies as well as in audit and assurance firms and in external consultancies.

We are taking up these issues with the industry and the stock exchange as part of our discussions of how to introduce ISSB requirements in the listing rules and how audit and assurance professionals can play a role.

Let me end by saying that the adoption of the ISSB standards in Hong Kong can have enormous global significance.

Regionally, a large amount of the capital flowing through Hong Kong is invested in Asia and its many energy-intensive developing economies, especially China. These economies have very large greenhouse gas emissions footprints and the greatest need for investment to fund the transition to net zero.

[2] Environmental, social and governance.

This is where the new ISSB promises to make such a difference, supporting the standards which individual jurisdictions may find it hard to develop on a domestic or regional basis.

With the ISSB set to establish the global baseline for sustainability reporting, the months ahead should represent an inflection point for climate finance.

Thank you.