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TORONTO CENTRE

THE NEW ISSB STANDARDS: CONSIDERATIONS FOR FINANCIAL SUPERVISORS

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Introduction[1]

The International Sustainability Standards Board (ISSB) adopted new standards in June 2023. These responded to demands from investors, the G7, and others for a global baseline of comparable, consistent, and reliable information on sustainability and climate-related risks and opportunities. The standards aim to help investors better evaluate potential investments, make more informed investment decisions, and steer more investments to areas that promote a clean and sustainable future, if investors prefer.

To date, sustainability reporting has been voluntary, based on sometimes overlapping and conflicting frameworks. The increasing ravages of climate change and the need for sustainable development have created a shared understanding of the threats of climate change – to financial performance, the financial system, and macroeconomic stability. Investors and financial supervisors need better information to identify these risks and to protect financial institutions and financial systems.

The standards have been widely applauded as a significant step forward, but their ability to create a global baseline will take time and effort. That will depend on whether jurisdictions adopt the standards and make them mandatory and how robust their enforcement capabilities are. Moreover, the ISSB adopted the standards quickly because of the urgent need for them. Refinements will be required as gaps in coverage become clear. These and the varying readiness of countries will influence the speed of change. The full benefits of implementation will likely emerge gradually over time.

This Note reviews the main components of the standards. It looks at how the standards might help supervisors achieve their goals of investor protection, the safety and soundness of financial institutions and systems, and reaching national climate targets. It also discusses several actions for securities and other supervisors[2] to consider as they work to strengthen implementation.

The ISSB Standards in brief

The ISSB has adopted two new standards: a general framework for sustainability reporting (Standard 1) and a specific approach for climate-related disclosure (Standard 2).

[1] This Toronto Centre Note was prepared by Alison Harwood. Please address any questions about this Note to publications@torontocentre.org.

[2] It is assumed that, in most cases, securities supervisors will lead implementation of the ISSB Standards.

It will develop standards for other sustainability-specific topics over time. Biodiversity loss is frequently discussed as the next topic, within the general framework set by Standard 1.[3]

The main elements of the new standards are that they:

- **Include a general sustainability framework plus climate-specific disclosures.**[4] The standards focus on improving the ability of investors to evaluate sustainability-related risks, opportunities, and metrics. S2 focuses specifically on climate change, targeted at reducing Greenhouse Gas (GHG) emissions and greenwashing. It explicitly includes banks, asset managers, and insurance firms.

- **Build on well-established frameworks and concepts** to facilitate faster, less costly development and use. They are based on the approach of the Task Force on Climate-related Financial Disclosures (TCFD), used by a growing number of firms worldwide, and the SASB Standards.[5] The ISSB has incorporated the TCFD recommendations and the SASB Standards.[6] Emissions reporting draws primarily on the Protocol for Carbon Accounting Framework (PCAF) and the GHG Protocol. The standards follow the IFRS's materiality definition and are designed to work with any accounting standards used to prepare financial statements.

- **Use a building block approach to interoperability.** Jurisdictions can adopt S1 and S2 as the core of their reporting and add more stringent requirements as they see fit. That will help to establish a global baseline and make it easier for jurisdictions, including those that are developing or have developed sustainability frameworks, to contribute to the global baseline.

- **Focus on financed emissions.** S2 focuses on financed emissions, divided into three Scope levels: direct emissions; indirect emissions generated by purchasing energy from others; and all other indirect emissions in a reporting company's value chain. Almost all financed emissions for financial institutions will be Scope 3 emissions.

- **Are highly supported by global bodies and standard setters and developed with extensive consultation.** This includes the G7, G20, the Financial Stability Board (FSB), and the International Organization of Securities Commissions (IOSCO), which has stressed the importance of adopting and implementing the new standards.

- **Have voluntary implementation**. The ISSB does not have enforcement authority. It is up to each jurisdiction to decide whether (and if so, how) to adopt the standards and whether to make them mandatory.

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[3] The ISSB will base its standard for biodiversity loss on the Task Force on Nature-related Financial Disclosure's (TNFD) framework. The TNFD is based on the Task Force on Climate-related Financial Disclosure (TCFD) structure and uses the same four disclosure pillars. The TNFD provides disclosure recommendations and guidance for organizations to report and act on evolving nature-related dependencies, impacts, risks, and opportunities.
[4] A later section of this Note discusses the application of the standards in more detail.
[5] According to CERES (2023), more than 3,400 companies and institutional investors in 95 jurisdictions have publicly endorsed the TCFD recommendations. The IFRS (2023a) reports that a 2023 analysis of global sustainability disclosure by 1,350 companies in 21 jurisdictions found that use of the TCFD recommendations grew from 24% in 2019 to 63% in 2021, and the SASB Standards from 15% to 49%.
[6] The Financial Stability Board has disbanded the TCFD task force.

- **Provide relief to recognize that countries are at different stages of readiness.** The ISSB recognizes that capacity, skills, and resources vary significantly worldwide. It provides several "relief measures" related to timing and content, as discussed below. The ISSB also acknowledges that, because of varying capabilities, the level and timing of benefits will vary across jurisdictions.

The standards are intended to be effective from January 1, 2024, for reporting in 2025. Entities should report their sustainability-related financial disclosures along with their related financial statements and cover the same reporting period.

How the ISSB Standards can help achieve supervisory goals

Key goals and how the standards can help achieve them

Physical and transition risks from climate change and their transmission to financial institutions (FIs) and systems have been widely discussed in the context of the TCFD recommendations and initiatives like the Network for Greening the Financial System.[7]

These risks can lead to corporate defaults that become investment and loan losses and drains on insurance providers. They can create credit, insurance, market, liquidity, and operational risks. They can threaten financial institutions, financial systems, and the broader economy through significant declines in asset and investment values, jobs, and employment opportunities. They intensify as climate change worsens.

Similar risks arise from other sustainability-sensitive areas. Examples include biodiversity loss, where deforestation can destroy the ability of land to absorb rainwater, causing destructive flooding and intensifying the effects of heatwaves.

FIs play a central role in the climate agenda. They are the vehicle through which most climate-related activities, positive or negative, are financed. As a result, they are exposed to considerable physical and transition risk. Financial supervisors will want to see that:

- Risks posed by climate change to investors, financial institutions, the financial system, and the macroeconomy are well managed.
- Climate and biodiversity-related risks are adequately disclosed to investors and consumers.
- Financing is allocated to positive climate areas to reduce climate risks and help countries reach national climate targets.
- A virtuous loop is created, with financing directed to greener climate-positive areas that lower climate-related risks, and fewer funds misdirected to 'browner' areas.

Consistent, comparable, and reliable information will help financial supervisors achieve these objectives and three key goals:

1. **Investor and consumer protection.** More robust disclosure can help retail and institutional investors identify material risks and opportunities that climate change and sustainability issues pose to investment options.

[7] Toronto Centre (2022 and 2023a).

It should also help investors and consumers to identify greenwashing, and therefore to make more informed investment decisions. These may lead to allocating more funds to activities with positive effects on climate and sustainability (if that is what investors want). Countries that manage their climate and biodiversity-related risks effectively will also be more attractive locations for investment.

2. **The safety and soundness of financial institutions**. FIs face potential risks from direct and indirect (via scopes 2 and 3) GHG exposures and from counterparties subject to climate and biodiversity-related risks. This is so even if these counterparties do not themselves generate GHG emissions.

   Improved disclosures provide FIs and their supervisors a more complete picture of exposures from entities they finance directly; supply chains they link to; financial institution counterparties they transact with; and collateral values and insurance plans they rely on. They help supervisors determine whether FIs are sufficiently identifying their exposures; have adequate capital, liquidity, or solvency positions; or need interventions to strengthen financial positions. As the International Association of Insurance Supervisors (IAIS) says, "[The standards] will further enhance insurance supervisors' ability to assess the exposure of insurance markets and insurers to assess sustainability and climate risks."[8] More standardized data across FIs also will mean supervisors can more easily confirm if claims FIs make about their climate contributions are accurate.

   Importantly, preparing disclosures will help FIs identify weaknesses in their internal processes and take steps to strengthen them – a critical end in itself.

3. **Financial system stability and alignment with national climate targets**. Enhanced disclosures will allow supervisors and macroprudential authorities to perform more meaningful vulnerability analyses of FIs and financial systems and more effectively identify and manage climate-related systemic risks. They should be able to more accurately track whether lending and investments align with national climate targets. Failure to meet climate and biodiversity targets means that financial institutions are facing ever-increasing climate and biodiversity-related risks.[9]

How well do the standards help achieve the goals?

The ISSB Standards are seen as a critical step forward for creating a global baseline, and from that, achieving the stated supervisory goals. As noted, jurisdictions already using TCFD and SASB will quickly see many benefits. The benefits will take longer in countries new to sustainability reporting. As noted, the standards need refining. Even for jurisdictions that are not starting from scratch, the initial benefits will be weaker than the intended results.

The ISSB notes throughout its documents that implementation is an evolutionary process. It advises that jurisdictions should incorporate improved data, more sophisticated approaches, and stronger capacity over time. Related to that, supervisors will want to focus on three issues to speed up implementation. These issues are not new, but the urgent need to address climate change and create a global baseline increases the pressure to manage them. They are:

[8] IAIS (2023).
[9] Toronto Centre (2022).

1. *Improving underlying data.* Many countries need more reliable data to produce informative sustainability and climate reporting. Forward-looking data are a particular challenge. The critical "data deficit" is widely discussed, and data vary widely by country. Generally, developed countries are further ahead. Financial supervisors can help by encouraging institutions they supervise to identify critical data gaps; lobbying for improved data resources; publicizing available resources, both domestic and international; and promoting the preparation and use of globally consistent approaches to data where possible.

2. *Strengthening implementation of TCFD and other standards on which the ISSB Standards are based*. Building the ISSB Standards on the TCFD recommendations and other frameworks currently used is a positive step that will encourage use of the standards. TCFD is a valuable and increasingly known framework. (A recent IAIS/CERES report highlighted how helpful TCFD has been for insurance regulators in obtaining more standardized information.)[10] At the same time, TCFD faces implementation challenges. It is in the early stages of use for many jurisdictions and companies, especially in developing markets. Supervisors will want to increase its broader understanding and use.

Table 1: TCFD Average Percentage of Disclosure by Region

Region	Percent
Europe	60%
Asia Pacific region	36%
North America	29%
Latin America	28%
Middle East and Africa	25%

Source: IFRS Effects Analysis (2023a)

3. *Increasing the ability to do scenario testing and transition planning*: Scenario testing by financial institutions and companies is critical to identify resilient and weak areas. Transition planning sets out a company or financial institution's strategy, targets, and actions to reduce its GHG emissions. This can feed into analyses of whether a country can reach its national targets. The ISSB Standards require preparers to perform **scenario testing and report on any transition planning they are doing**. **Many FIs say they are not ready to do this.** As the Institute for International Finance (IIF) says, "A lack of data on counterparties' climate-related characteristics such as current Scope 1, 2, and 3 emissions and transition plans is a significant inhibitor for many FIs in their transition planning."[11] The ISSB recognizes these limitations and allows various relief measures, including letting an entity report in line with its circumstances. Supervisors will want to identify how to help companies and FIs in their jurisdiction improve their capabilities. They will also want to enhance their capabilities to do these analyses, a central component of the Network for Greening the Financial System's recommendations.

[10] CERES (2023).
[11] IIF (2022).

Issues related to emissions reporting

A different set of issues concerns emissions reporting. Disclosure using S1 and S2 is expected to significantly improve the quality and extent of emissions reported and reduce challenges like greenwashing. However, there are significant challenges to calculating emissions, particularly Scope 3 emissions.

A starting point is that S2 does not include facilitated emissions because it considers the approach to calculating them to be underdeveloped.[12] Facilitated emissions are from off-balance sheet, investment banking activities like underwriting, securitization, and advisory services such as structuring and pricing. The FI does not create emissions from the transactions, but its services might help an entity raise capital for operations that might create high emissions. An FI considered to have thus facilitated high GHG emissions can face reputation risks that reduce its revenue streams and financial strength.

Excluding facilitated emissions may result in underreporting financial institution risk and, in turn, systemic risk. Securities supervisors will want to consider how extensively these emissions affect their local FIs, financial markets, and climate targets. If they are essential, securities supervisors can follow the ISSB as they incorporate accounting for facilitated emissions into S2.

The broader issue is that reporting Scope 3 emissions is essential for evaluating climate-related risks and opportunities for investors and FIs. It is also essential for determining whether their activities are aligned with national climate targets. For FIs, it accounts for almost all their emissions. However, Scope 3 reporting is highly challenging to calculate. Omitting it can significantly misrepresent company and financial institution climate-related risks and the ability to transition to planned climate targets. It can also mislead investors and generate prudential concerns.[13]

The challenges are daunting. FIs need to obtain emissions data from all the entities they finance. Those entities need to get Scope 3 data from their supply chains. The quality and reliability of climate-related disclosure are still evolving, mainly around Scope 3 reporting. Even if reliable data are available, they can be difficult to obtain on a timely basis. FIs can ask those they finance to facilitate the process, but that can be time-consuming, they may face resistance or delays, and they will need help to verify the information they receive. As IAIS, IOSCO, and the IIF have commented, financial institutions cannot be expected to confirm the quality of emissions reporting they receive from those they finance/invest in.

Given the critical importance of Scope 3 reporting, supervisors should make addressing its challenges a priority – for developing data, analytics, and capacity. They also need to evaluate and communicate how the lack of Scope 3 reporting might affect their GHG emissions calculations and their prudential evaluations.

Supervisors should also encourage the development and use of assurance standards and assurance providers by FIs and companies. Assurance will help verify information, particularly related to GHG emissions. To improve the assurance industry, the International Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants are putting together a global assurance framework.

[12] IFRS (2022), PCAF (2022).
[13] CERES, in its July 29, 2022, letter to the ISSB, noted that "GHG Scope 3 emissions assessment and disclosure is rapidly emerging as a standard expectation for all market participants."

This will create standards for sustainability assurance providers. They are working with the ISSB to ensure compatibility. IOSCO is urging this development.[14]

The ISSB is not mandated to require assurance. Jurisdictions must decide whether to require assurance and to what degree, considering their circumstances.[15] Supervisors should also consider adopting 'safe harbour' provisions to protect FIs from legal liabilities related to sustainability reporting, which many jurisdictions are adopting. The ISSB does not provide a safe harbour provision but suggests that jurisdictions consider providing one.[16] Supervisors should keep updated on global efforts to develop assurance capabilities, ensure that preparers in their jurisdictions know where to find credible sustainability assurance providers, and take steps to develop domestic resources where needed.

Relief measures and flexibility

As noted, the ISSB recognizes that countries are at different stages of development, with varying levels of skills and data to prepare the disclosure required in S1 and S2. It has provided several relief measures and flexibility to help jurisdictions and preparers transition to a stronger position. Some of these are major, as outlined in Box 1. Others are more specific and defined throughout the ISSB documents.

Box 1: ISSB Relief Measures

The ISSB Standards are based on two underlying premises that apply to all reporting:

- Companies can use information that is less costly as long as it is reasonable and supportable.
- A company can provide qualitative information if quantitative information is not clear enough or the company lacks the skills, capabilities, and resources to provide it.

Specific relief measures relating to the disclosure content include:

- Only having to report on S2, climate-related risks, and opportunities in the first year.
- Not having to report on Scope 3 emissions in the first year.
- Not having to reassess the scope of a company's value chain and the categories included in measuring Scope 3 GHG emissions unless a significant event or change of circumstances occurs.
- Using an approach to climate-related analysis that fits the preparer's circumstances at the reporting time.

Providing relief measures is a positive step. At the same time, flexibilities can create holes in the system, compromising information and weakening its value for investors and prudential assessments. Allowing companies to substitute qualitative narratives for quantitative data, for example, can put considerable pressure on supervisors who have to judge what the qualitative information means.

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[14] IOSCO (2023).
[15] The European Sustainability Reporting Standards and the U.S. SEC's proposed rule on climate-related disclosure require limited assurance.
[16] IFRS (2023a, p 31).

Quantitative data are typically more precise, easier to understand, and involve less judgment to analyze. Supervisors might therefore prepare criteria for deciding which measures to apply and how. They will also want to join together to identify and push responsible parties to provide the needed data and help build capacity so their jurisdiction can evolve to more quantitative reporting.

Voluntary adoption

The ISSB Standards are voluntary. The ISSB does not have the authority to impose mandatory requirements. Jurisdictions will have to decide whether to adopt the standards and, if so, whether to make them compulsory for reporting companies. If jurisdictions do not adopt the standards, that will reduce the ability to create a global baseline and add another voluntary approach, increasing confusion and inconsistency. This is discussed further below.

Box 2: What ISSB is not; impact versus financial reporting

The ISSB Standards are not intended to identify an investment's impact on the broader climate environment. They focus on how climate risk affects an institution's financial performance (single materiality). The EU follows a double-materiality concept, evaluating an investment's environmental impact.

The standards are also not intended to be used by financial supervisors to steer investments to the most climate-positive ones or stop investors from investing because an opportunity has significant emissions. The improved disclosures are intended to enable investors to take such actions independently if they choose to do so.

Direct impacts on investment flows could be affected through other types of actions. The Ministry of Finance could impose higher and more broad-ranging carbon taxes. The Ministry of Energy or Environment or Finance might provide tax credits or other financial incentives to encourage investments in solar or climate-friendly sectors. Conversely, they might fine high-emitting companies and create transition risks that make the investment unattractive.

Financial supervisors may want to share the information they collect with, for example, the Ministry of Environment. The Ministry may use that information in its calculations about the state of the jurisdiction against its climate targets.

Key policy decisions

Supervisors should consider four key points when evaluating whether to adopt and apply the ISSB Standards: Should the standards be adopted; if so, who should they apply to; should they be mandatory; and how to address interoperability.

Should the standards be adopted?

Though the standards need refinement and will take time to set up effectively, there are many benefits to adopting them today. Most importantly, they will help create a global baseline.

Failure to adopt them will cause a double-negative: it will reduce the ability to promote a much desired global baseline *and* add more uncertainty to an already confusing sea of voluntary reporting approaches.

Other, more specific reasons to adopt the standards include that they:

- **Reduce costs in time and money for issuers**, **particularly companies that operate in multiple markets.** Companies can use one reporting format for all the jurisdictions they operate in.

- **Provide a clear way forward for countries building sustainability frameworks**. The standards clarify how to create a logical approach from many available standards and how to strengthen coherency over time. This roadmap will significantly benefit emerging market countries (EMCs), as many are beginning this journey. Several countries like Nigeria, Ghana, and Zimbabwe have indicated they plan to build the standards into new or existing regulations.[17]

- **Are supported by leading global organizations and standard setters so they are likely to become the norm.** Jurisdictions that fail to adopt them will be out of sync with their peers regarding regulatory and prudential issues and approaches.[18]

- **May help attract capital, particularly foreign investors, and at a lower cost.** Following the standards with their greater transparency, comparability, and reliability can help attract domestic and global capital. That can be a significant step forward, particularly for emerging market countries where most climate financing is needed.

Supervisors should recognize that applying the standards will create costs for preparers and regulators. The costs can be significant, especially in the early years and for jurisdictions new to sustainability reporting. These costs should gradually reduce as preparers and regulators adopt new processes, develop needed data, and become more adept at producing disclosures.[19] It is another reason for quick advancements in education, data, and other needed inputs.

Technology can help reduce disclosure costs in time and money – to prepare and evaluate information, obtain assurance, and track progress. It can also simplify the process of calculating GHG emissions.[20] The ISSB is looking to digitize classification and reporting to increase information access and comparability and reduce processing costs. Supervisors should develop systems that interface with this and other valuable platforms. Digital approaches can be most beneficial for EMCs and smaller companies.

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[17] Pierce (2023a).
[18] It is unlikely that jurisdictions will create new sustainability and climate standards that differ from the ISSB Standards. As Rodrigo Buenaventure, IOSCO's Chair of the Sustainable Finance Taskforce, noted, after the IFRS accounting standards were adopted, countries that needed a more robust accounting system and wanted to fit into the global economy adopted the IFRS standards. Over 140 countries now follow them. Similarly, he expects that new sustainability standards are likely to converge to the ISSB Standards. Toronto Centre (2023b).
[19] The ISSB noted that a "2022 survey of US institutional investors and companies estimated that large investors spent an average of US$993,000 annually on collecting and analyzing climate-related Toronto to inform their investment decisions" and "companies spend an average of US$553,000 annually…" It says the sample sizes are small, but they indicate the substantial costs involved. IFRS (2023a, p 35).
[20] Pierce (2023b).

Who should the standards apply to?

Since the standards are voluntary, jurisdictions will need to decide whether to adopt them and, if so, which reporting entities must use them. Any company – public or private, large or small – can report using them. Even if entities are not required to use the standards, their investors, customers, and other stakeholders may require reporting with the ISSB Standards as they become common. Companies and financial institutions, particularly multinational ones, may push their jurisdictions to adopt the standards because of the cost savings.

If jurisdictions decide to adopt the standards, additional decisions concern four points:

- **Which types of FIs to include.** Jurisdictions can follow the ISSB's approach and apply S2 to banks, asset managers, and insurers to start.[21] Pension funds are not explicitly included. Asset manager reports should capture most of their investments. Pension fund supervisors may want their pension funds to prepare the disclosures, especially when they account for a significant part of the country's financial assets. This is to identify potential risks, to see how their investments align with national targets, and to strengthen a pension fund's internal risk-management and metrics. Including securities firms is related to including facilitated emissions. Supervisors can evaluate the tradeoffs between excluding potential risks from facilitated emissions and employing an immature reporting calculation. Whatever the decision, they should follow ISSB actions as it works to incorporate facilitated emissions and securities firms in S2. They should also be prepared to assume that reporting when it is incorporated.

- **Whether to include private as well as public companies.** The goal is to capture companies with the highest potential impact on sustainability and climate. Large companies typically make substantial impacts in any market and should be included, whether public or private. Many jurisdictions, like the EU and the UK, require large private companies to prepare sustainability reports.[22] The EU includes all large companies, including non-EU-based and publicly listed SMEs (see Table 2).[23]

Table 2: EU Disclosure Requirements by Company Type

Size	Public	Private
Large	X	X
SME	X	
Non-EU Large	X	X

- **Whether to include non-regulated FIs.** As regulated FIs transition to green investments, non-regulated FIs may increase their brown exposures. This creates risks not captured in vulnerability analyses or national accounting related to climate targets.

[21] The ISSB only specifies about including these financial institutions in S2.

[22] A different reason to consider applying the standards to private companies, particularly large ones, is to create a level playing field for reporting. Sizable differences in reporting requirements can push companies out of public markets. There are many general and sustainability-related benefits for companies to remain public. It would be unfortunate if reporting for a positive goal caused companies to delist or not list.

[23] IFRS (2023a, p 18, 21).

Jurisdictions should evaluate the role of non-regulated FIs and whether excluding them would potentially be damaging.

- **Whether to include SMEs**. Using the standards will be challenging for most SMEs, but omitting them can compromise the emission analyses of financial institutions that finance SMEs directly or finance larger companies that have SMEs in their supply chains. Many SMEs operate within global supply chains, and upstream companies may ask them to disclose following the standards. SMEs also comprise the bulk of economic activity in many emerging market countries, which can be an argument for including them.[24]

The ISSB suggests ways to reduce costs and make it easier for smaller firms to use the standards, including by allowing scaled approaches and reliefs. Applying the standards will still be demanding. Supervisors can consider how much SMEs add to the jurisdiction's risks and exposures, what that suggests for how extensive and quickly SMEs should be required to report, and whether they have the capacity to process SME reporting. Most likely, supervisors will want to incorporate the particular needs of SMEs into capacity-building and data exercises.

Should the standards be mandatory?

The standards will only work as a global baseline if they are widely adopted by jurisdictions, made mandatory, and enforced. Given there will be a baseline supported by leading standard setters, stock exchanges, investors, and many multinational companies, the standards may become the norm and effective without compulsory adoption. Investors can continue to be a pressure point, voting with their money and pushing companies and financial institutions to prepare this disclosure. But that is not an ideal solution.

The more countries and jurisdictions make the standards mandatory, the more influential the standards will be in providing consistent, comparable, and reliable information. Voluntary approaches can open the door to weaker implementation and information. As a result, there is a growing trend for forced adoption of sustainability disclosures, including from the G7, EU, and recently Brazil.

Applying interoperability

The ISSB has adopted a building block approach, so jurisdictions can adopt S1 and S2, be part of the global baseline, and add more strict elements if desired. Jurisdictions such as the SEC and the EU that have adopted or are well along the path to adopting sustainability and climate-reporting frameworks are looking to make their standards work with S1 and S2. Many of the approaches being developed are based on the TCFD recommendations and other ISSB-used frameworks, making alignment easier. Still, significant work will be needed to make interoperability a reality.

The ISSB has several initiatives to improve interoperability with various jurisdictions and other standards, including the Global Reporting Initiative Standards. It will be to the benefit of supervisors and the global financial system to work with the ISSB to see how to integrate existing or planned sustainability disclosure approaches so S1 and S2 can form their core.

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[24] Improved transparency benefits SMEs and other companies, such as in managing risks, attracting financing, and preparing for global expansion.

Moving forward

Implementing the ISSB Standards will not be easy. They are complex and involve considerable exploration to understand all their elements and how to apply them. But they are a critical step in the right direction.

As a starting point, supervisors need to know that (1) implementation and its benefits will be gradual; (2) how fast the benefits are seen will depend on the starting point and ability to improve capacity and resources; and (3) implementation will start with companies that have most actively reported using the TCFD recommendations and other included approaches. This should include a larger group and more extensive benefits over time.

That said, there are three connected steps supervisors can take: (1) develop and engage with a collaborative group of financial supervisors; (2) build capacity; and (3) collaborate with the global community.

Collaborating at home

The first step is to develop a collaborative group of financial supervisors.

Securities supervisors play a leading role since the standards were mainly adopted to improve disclosure and protect investors. But there is a critical need for strong cooperation and coordination with and among other financial supervisors – banking, insurance, and pension supervisors and central banks. The FIs they oversee will have common exposures and potential risks; the risks can be transmitted across the financial system and beyond; and they all contribute to achieving national climate targets. All financial supervisors have expressed strong support for the standards and want to be involved in applying them to benefit their micro- and macroprudential supervision.

Combining supervisory information, institutional connections, and insights will lead to higher quality disclosures and assessments, and a more complete understanding of risk and climate implications. Financial supervisors are best positioned to determine the information to collect from their FIs, identify institutional and systemic risks from those they oversee, and respond with regulatory actions.
Insurance and banking regulators have worked together in several countries to identify how climate change can stress insurance resiliency and how those stresses might transfer to individual banks and the banking system.

Thus, a starting point is to create an inter-agency committee (or inter-department one, if supervisors are under one financial agency) on climate-related issues. Below are some suggested areas that supervisors might focus on together. They will need to determine when to apply separate approaches for their particular institutions. Roadmaps, policies, and definitions are likely to vary considerably by jurisdiction, given different starting points.

In terms of operations, some suggested collaborations are to:

- Prepare a strategic plan of action: Identify goals and priorities and prepare a roadmap of actions to move forward. Prioritizing steps will be critical.

- Define policies and content: Decide on key policies, determine definitions for areas such as the meaning of materiality, and decide on judgment calls for using qualitative information and other relief measures. Determine when these may differ by institution type.

- Develop shared tools: Create common scenario analyses; run coordinated stress tests and determine shared responses; and develop a model for assessing the transmission of risks from one type of FI to another as part of tracking institutional and systemic vulnerabilities. An example might be from the insurance to the banking sector so that banks can estimate the probability of a default based on the insurance gap.[25]

- Monitor and share information on progress and experiences: Share information to create scenario analyses and other prudential evaluations and build on implementation challenges and experiences to strengthen their jurisdiction's ability to evolve.

In addition, supervisors together can raise awareness and gain input from the broader community. For example:

- Communicate and raise awareness: Educate stakeholders about the importance of the standards and steps to improve their introduction, particularly in countries new to the sustainability agenda. Importantly, keep investors updated on the country's reporting levels and financial system risk identified through scenarios, which is critical contextual information for investors.

- Advocate actions by others: Call for responsible entities to prepare data, classification, and other necessary inputs. Highlight how improved sustainability and climate reporting can help achieve national targets, reduce systemic risks, and attract more investments.

- Create a working group of broader stakeholders, including select investors, companies, other government agencies, and academics. This allows for ongoing input into how the standards are defined and applied and allows supervisors to be better informed in their engagements with global bodies.

Building capacity

The second step is to build capacity and infrastructure to implement the standards.

Reporting entities and supervisors will need extensive capacity-building to create and evaluate meaningful disclosures. Particular actions needed include:

- Securities supervisors and other supervisors who plan to use the disclosures need to develop staff specialized in evaluating reports. This includes how to apply policies and relief measures, assess qualitative narratives, form judgments on what is acceptable, and perform, interpret, and react to scenario analyses. They will want to ensure that FIs – and, for securities supervisors, the companies they supervise – have the necessary skills and draw on available capacity-building resources. To the extent SMEs are asked to report, they will need special capacity-building programs to address their particular concerns.

[25] The FSB (2022) provides numerous examples of how supervisors have worked together on these issues.

- Preparers of the reports (e.g., companies and FIs) need the skills and internal processes to prepare the disclosure, do scenario analysis, access and evaluate data, and prepare narratives for and manage their strategy, governance, and risks. Preparing Scope 3 emissions will be a sizable challenge, particularly in the early days.

- Investors need education on how to evaluate the reports and to understand what the information provided does and does not cover. This includes information about financial system risks.

Collaborating globally

The third step is to engage closely with the ISSB, standard setters, and the global community.

There are strong benefits to cooperating and coordinating internationally. Many FIs and companies operate in multiple jurisdictions, and risks can be transmitted across as well as within borders. Consistent definitions, disclosure approaches, and scenario analyses to identify risks and share information on potential risk linkages will improve prudential risk management. This will also make it easier and less costly for companies and FIs to operate globally.

The ISSB, standard setters, and industry groups will provide training and support to help jurisdictions build the extensive knowledge and skills needed to implement the standards (see Box 3). Securities supervisors and other FI supervisors will want to stay connected to the ISSB, standard setters, and other global counterparts to keep updated on new developments; learn from others and share experiences; and have their insights factored into how the standards are refined. Engaging with peers through standard-setting bodies will be especially constructive. Companies, investors, and others such as accountants and assurance providers will benefit similarly from involvement with their global counterparts.

Box 3: Training and other support for aligning with the ISSB Standards

The IFRS Foundation recognizes the significant challenges to adopting the standards. It has created several materials and means to help jurisdictions move forward. Securities supervisors should take advantage of these resources and encourage their use by preparers, users, and other stakeholders. These include:

- Adoption guide to support jurisdictions in deciding whether and how to adopt the standards.
- Partnership Framework for Capacity-Building to support companies, investors, and other capital market stakeholders as they prepare to use S1 and S2. This includes partnerships to address the specific needs of emerging markets and small companies.
- Application guidance that covers a range of issues, including how to do scenario analysis and how to determine Scope 3 GHG emissions.
- Sustainability Standards Advisory Forum, where members can support the ISSB in developing and refining its standards.
- Ad hoc engagements with individual countries.

Various standards setters (for example IOSCO) and other global groups (for example the Sustainable Stock Exchange Initiative) are also providing assistance.

Conclusion

The ISSB Standards are a significant step forward in creating a much-needed global baseline for sustainability and climate reporting. They should lead to more informed investment decisions, greater allocation of funds to climate-friendly areas, and less misallocation of financial resources. This in turn will lead to more robust assessment and management of financial institutions and systemic risk and a country's alignment with national climate targets. They create a framework to develop standards for other critical sustainability areas like biodiversity loss.

The standards were adopted with unusual speed in response to urgent calls for their development, given the increasing effects of climate change. They are highly applauded, but refinements are needed. They must be seen as a work in progress. Implementing the standards will be challenging, especially for jurisdictions new to sustainability reporting. Data and capacity enhancements are particular areas for future work.

This Note discussed the benefits, challenges, and actions needed for the standards to reach the goals they were set out to meet. An important point is that coordinating and cooperating at home and abroad (see Table 3) will help speed up implementation for all financial supervisors, reporting entities, and users.

Table 3: Recommended Financial Supervisor Actions

Issues	Specific Steps	Comments
Content-related actions to define and strengthen implementation	• Set definitions, for example, for materiality, time periods • Improve data • Strengthen the use of TCFD and other core standards • Make addressing Scope 3 reporting challenges a priority • Improve the ability to do scenario analyses and transition planning • Take steps to include facilitated emissions as ISSB work progresses • Monitor Assurance developments; consider adopting assurance requirements at home	Likely led by the securities supervisor. The first five points should be worked on with banking, insurance, and pension supervisors. The last two points are for the securities supervisor.
Broad policy decisions	Determine: • Whether to adopt the standards • Which financial institutions they apply to • Whether to include private as well as public firms • Whether to include non-regulated FIs • Whether to include SMEs • If the standards should be mandatory • How to make the standards interoperable	Likely decided by the securities supervisor but input should be sought from banking, insurance, and pension supervisors
Collaborating at home	Create a financial supervisor working group, including to: • Determine content and policy decisions (as mentioned earlier) • Create a roadmap for action • Share information and experiences • Monitor ongoing use and development • Advocate for data from others • Raise awareness • Build capacity (see below) Create a stakeholder working group to identify ongoing needs, uses, challenges, and solutions	Organized by the securities supervisor and including banking, insurance, and pension supervisors Organized by the financial supervisor working group, led by the securities supervisor

Building capacity	• Provide training programs and materials – together, separately, and with or from others, including internationally (see below) • Focus on preparers and financial supervisors, as well as investors and other key stakeholders • Help with preparing materials, making judgments, evaluating qualitative information	Coordinated efforts to prepare consistent training materials, with specialized elements and programs for institutions they oversee
Collaborating globally	• Draw on ISSB, standard setters, and other training programs, materials, and support • Contribute to ISSB discussions to refine the standards • Encourage companies, investors, and other key stakeholders to do the same	All supervisors should actively engage with global initiatives and strongly encourage those they supervise to do so as well

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