Input to the elements paper on Financing for Development

Action area: Domestic and international private business and finance

Feasible approaches to enhance the interoperability of sustainable finance frameworks

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1. Challenges of the current international sustainable finance architecture[1]

The objective of sustainable finance is to redirect capital flows from unsustainable to sustainable economic activities, with the ultimate goal of transforming the real economy towards a sustainable future. In order to prevent greenwashing and better align the financial sector with sustainability goals, it is essential to establish a credible framework for sustainable finance. The provision of information and transparency on sustainable activities is a crucial element in achieving this. For instance, sustainability taxonomies and disclosure requirements play a pivotal role in sustainable finance strategies by defining sustainable economic activities and increasing transparency in financial markets.

Nevertheless, a global proliferation of sustainable finance regulations and standards has emerged. The coexistence of numerous sustainable finance regulations and taxonomies gives rise to regulatory ambiguity, rendering it challenging for market participants to remain informed

From an international perspective, there is a need to foster coherence and harmonisation in order to prevent fragmentation in the market and to facilitate the interoperability of strategies for sustainable finance, including the utilisation of taxonomies. This will ultimately enable the facilitation of cross-border investments in sustainable initiatives. Interoperability can be defined as the ability to transfer assessments between different frameworks with ease, utilising comparable structures, such as similar metrics, industry classification systems, and templates. This is to ensure sufficient comparability and interoperability between the approaches so that they can be used in multiple jurisdictions and are accepted as credible. Furthermore, there should be clarity about how each instrument can interact with others (IPSF 2021). Accordingly, this does not mean that all systems and instruments of sustainable finance frameworks need to function in the same way.

[1] A summary of this paper is also included in the ETTG (2024) input for elements paper on Financing for Development, "Aligning Climate Action and Development through SDG Financing: The Role of FfD4," Action area: Domestic and international private business and finance.

Conversely, the harmonisation of sustainable finance strategies is associated with a number of challenges. These include: (i) discrepancies in the maturity and structure of financial markets, including the relative importance of capital markets versus bank financing, the role of international capital; (ii) differences in the economic structure; and (iii) alignment with national regulations and sustainability goals. (Berensmann, 2024; UN-DESA & IPSF 2021; UN-DESA 2024).

In particular, the development of universal taxonomies for different jurisdictions and countries with unique circumstances, including different economic structures, poses challenges for global harmonisation. Sustainable finance taxonomies for developed countries with relatively mature financial markets may not be appropriate for developing countries with less developed and differently structured financial markets. This is because, for example, the taxonomies cannot be linked in the same way to sustainable finance instruments such as green bonds. In addition, sustainable finance strategies for countries with large capital markets may require different strategies than for countries where bank finance is dominant. Furthermore, differences in data availability and previous experience with sustainability reporting complicate the alignment of sustainable finance standards. This is illustrated, for example, by the challenges faced by South Africa in implementing its green finance taxonomy, which closely follows the EU taxonomy (Hilbrich et al., 2023). In addition, different industry structures may be a reason to focus on different sustainability challenges.

In sum, a more flexible approach is recommended, taking into account the industrial structure of countries and the development of their financial markets, including the quality of their institutions and human resource capacity.

2. Options to enhance the interoperability of sustainable finance frameworks

The forthcoming Fourth International Conference on Financing for Development could not only be an adequate forum for Member States to pursue their cooperation on financial regulation and prevent fragmentation, while respecting regional and local particularities, but also to discuss viable and practical solutions/steps to enhance the interoperability of sustainable financial frameworks worldwide.

Against this backdrop, policy solutions to enhance the interoperability of sustainable finance taxonomies include:

- ***Develop similar designs***: It is recommended that common principles be developed in accordance with the suggestions put forth by UN-DESA and the International Platform on Sustainable Finance (IPSF) in 2021 and in Ehlers / Gao / Packer, F. (2021). In order to align investments with SDGs, it is essential that (i) a positive contribution is made to at least one of the 17 SDGs, (ii) any potential negative impact on the 17 Sustainable Development Goals is avoided (do not significantly harm criteria), (iii) the approach is scientifically sound, and (iv) the approach is clearly defined and published. The metrics and thresholds should be based on the best available scientific evidence and be internationally compatible. Furthermore, they should be flexible enough to take into account country-specific circumstances and new developments, such as market changes, as well as the development of green and sustainable technologies. Finally, they should be transparent and based on sound methodologies, including appropriate disclosure rules and independent verification mechanisms.
- ***Establish an international recognition mechanism and promote the dialogue in inclusive fora*** such as the UN to achieve mutual recognition of the equivalence of sustainability taxonomies with similar levels of ambition, an international recognition mechanism is needed (Hilbrich et al. 2024). Investments that have been shown to be

sustainable according to one jurisdiction's taxonomy are automatically considered to be in line with another jurisdiction's taxonomy. This mechanism should not lead to a lowering of the level of ambition; only taxonomies with a similar level of ambition should be recognised as equivalent. Some differences between taxonomies are necessary to take account of country-specific circumstances, but avoid shortcomings associated with the existence of a patchwork of different regimes.

References

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