# SAG Proposal: ISO Strategic Engagement in Environmental, Social, Governance (ESG) Ecosystem

In recent years there has been a shifting tide in the private sector, a movement away from shareholder focus to a more holistic corporate model that considers a variety of stakeholders.[1] This shift in values is reflected by a movement in organizations to become more responsive to their stakeholders while responding the positive and negative environmental and social impacts of their operations, while demonstrating sound governance practices. Organizations disclose these impacts and activities through environmental, social and governance (ESG) disclosure frameworks and standards. While these frameworks are currently voluntary, various jurisdictions have also been developing mandatory disclosure frameworks on ESG indicators, such as the European Directive on Non-Financial Reporting.

The use of standards and frameworks to help organizations demonstrate their compliance with ESG indicators has been growing. In 2018, 86% of the S&P 500 companies reported on ESG issues.[2] The global sustainable investment saw a increase of 34% between 2016 and 2018, pointing to a rapid uptake and adoption of sustainable investment strategies by companies.[3] The value of sustainable investment in five markets alone (Europe, United States, Japan, Canada, Australia/New Zealand) was $30.7 trillion in assets, which is the equivalent to “one third of professionally manages assets” in 2018.[4] The increase in uptake of ESG disclosure is not limited to these 5 markets, for example, in Singapore 40% of assets managed incorporated ESG factors.[5] Furthermore, this estimate does not include other types of organizations who are also working towards aligning their operations to ensure positive ESG impacts. Therefore, this is likely an underestimate of the overall global magnitude of assets that are managed using a variety of ESG strategies.

While disclosure and reporting has been gaining traction in the context of sustainable finance, it is not limited to the interests of investors and issuers. Interest in ESG performance of organizations involves many additional groups of stakeholders including:

- organizations’ own Board of Directors who would like to ensure long-term sustainability of the organization, its reputation, and governance,

[1] Shared Value Initiative (2020) *Hybrid Metrics: Connecting Shared Value to Shareholder Value*.
[2] *2018 Global Sustainable Investment Review* (2018). http://www.gsi-alliance.org/trends-report-2018/ [accessed April 24, 2021]
[3] “FLASH REPORT: 86% of S&P 500 Index® Companies Publish Sustainability/Responsibility Reports in 2018” Government Accountability Institute, May 2019.
“2018 Global Sustainable Investment Review” Global Sustainable Investment Alliance, March 2018.
[4] “FLASH REPORT: 86% of S&P 500 Index Companies Publish Sustainability/Responsibility Reports in 2018” Government Accountability Institute, May 2019.
“2018 Global Sustainable Investment Review” Global Sustainable Investment Alliance, March 2018.
[5] Choy, N. (2021, April 15). *Business Times*. Retrieved from https://www.businesstimes.com.sg/banking-finance/80-of-singapore-investors-believe-in-esg-but-only-a-quarter-take-action-survey
Global Compact Network Singapore. (N/A). “What We Do” https://unglobalcompact.sg/what-we-do [accessed April 22, 2021]
Walker, R. (October 20, 2020). *Fund Selector Asia*. Retrieved from https://fundselectorasia.com/esg-assets-grow-in-singapore/ [accessed April 20, 2021]

- policy makers and regulators, who are looking to fund companies that align with policy objectives related to ESG (e.g. public procurement, grants and contribution).[6]
- Regulators who are looking for transparent processes to regulate companies, particularly in the natural resource sector or in polluting sectors.
- consumers looking to make purchasing decision based on ESG practices of companies.

Designing tools that also meet their needs is important in expanding the use of the tools developed in the context of sustainable finance.

Sustainable finance, impact investing, and ESG investing have emerged from socially responsible philosophies[7]. While emerging from different groups of stakeholders and goals, these philosophies call for businesses to operate in a transparent environmentally and socially responsible way, and to practice good governance. Recent studies have demonstrated the link between ESG, short-term, and long-term performance of firms, solidifying the argument for taking these elements into consideration by Board of Directors and investors.[8] However, while the number of ESG and corporate social responsibility reports increased, global $CO_2$ emissions continued to increase, so has social inequality. Reporting hasn't delivered on its promise strengthening the arguments of green washing, and diverting resources from tackling the issues.[9] Pucker summarized some of the challenges: [10]

1. no agreed upon definition of what is sustainable investment
2. reporting on ESG indicators does not guarantees improvement
3. there are no continual improvement mechanisms built in reporting and disclosure standards organizations can choose to continue their operations as long as the risk is tolerable
4. complete discretion over which disclosure framework to choose and what indicators to report on together with no accredited third-party auditing or validation
5. non-standardized reports and metrics make it difficult for consumers to interpret and make decisions upon

ESG disclosure frameworks and standards are a tool to link the environmental, social and governance operational practices of firm to capital markets. Disclosing ESG data allows organizations to demonstrate their efforts to meet environmental, social and governance best practices. By being rated against ESG standards, companies can signal investors of their long-term value creation potential. Yet, many still see these efforts as marketing and "green washing efforts". However, these traditional uses of ESG frameworks can serve not only investors but also governments in procurement and regulatory processes and consumers in identifying which vendors or companies align with their values, as related to ESG considerations.

[6] European Commission. Non-financial Reporting. https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_en [accessed March 23, 2021]
[7] Boffo, R., and R. Patalano (2020), "ESG Investing: Practices, Progress and Challenges", OECD Paris, www.oecd.org/finance/ESG-Investing-Practices-Progress-and-Challenges.pdf
[8] Guido Giese and Linda-Eling Lee (2019). Weighing the Evidence: ESG and Equity Returns. http://www.msci.com/documents/10199/9aec76d8-376f-91ef-a575-b2b0ea65061a
[9] Pucker, P. Kenneth (2021). "Overselling Sustainability Reporting". Harvard Business Review. https://hbr.org/2021/05/overselling-sustainability-reporting [accessed April 24, 2021]
[10] Pucker, P. Kenneth (2021). "Overselling Sustainability Reporting". Harvard Business Review. https://hbr.org/2021/05/overselling-sustainability-reporting [accessed April 24, 2021]

This rapidly evolving ecosystem and its challenges provide ISO an opportunity to act on its 2030 strategy and strengthen its work under the following priorities:

1. Innovate to meet users' needs and meeting global needs
2. Deliver ISO standards when the market needs them
3. Capture future opportunities for international standardization

Below is a description of the key challenges and opportunities, ISO's work in the ESG ecosystem, and proposed next steps.

## The Challenges & Opportunities

There are three core challenges that emerge in this space, all touching on ISO's domain and expertise and provide opportunities to deliver solutions that address the needs of users. Each challenge also has opportunities to be leveraged on. Appendix II illustrates the experience of a fictional company through their journey to report on ESG indicators and highlights the key challenges.

### 1. Lack of harmonization and consensus in the proposed ESG frameworks

**Challenge:** There are many frameworks to report on ESG indicators, each serves different purpose and has slightly different scope, with some overlap.[11] Furthermore, companies have the freedom to choose which framework to use and which indicators to report on, which makes it extremely difficult to compare between companies.[12] There has been a movement globally and a call to develop common approaches to ESG reporting and its associated metrics.[13] This lack of harmonization leads to difficulty in reporting, with companies required to report on over 500 indicators.

**Opportunity:** International standards can serve as one of the tools to establish common grounds across the various frameworks. While some proposed frameworks for harmonization are referencing International Standards published by ISO, these references are not consistent. This inconsistency presents an opportunity for outreach and engagement with key ESG framework owners to better leverage ISO standards. By referencing ISO standards these frameworks will provide a unified approach using globally accepted, well established standards and an opportunity to expand the reach and use of ISO standards to make lives easier, safer, and better.

[11] Corporate Reporting Dialogue. *The Landscape Map – Corporate Reporting Dialogue* https://corporatereportingdialogue.com/landscape-map/ [accessed March 30, 2021]
[12] Pucker, P. Kenneth (2021). "Overselling Sustainability Reporting". Harvard Business Review. https://hbr.org/2021/05/overselling-sustainability-reporting [accessed April 24, 2021]
[13] World Economic Forum. "Toward Common Metrics and Consistent Reporting of Sustainable Value Creation" https://www.weforum.org/whitepapers/toward-common-metrics-and-consistent-reporting-of-sustainable-value-creation [accessed March 30, 2021]
IFRS (March 8, 2021) "IFRS Foundation Trustees announce strategic direction and further steps based on feedback to sustainability reporting consultation" https://www.ifrs.org/news-and-events/2021/03/trustees-announce-strategic-direction-based-on-feedback-to-sustainability-reporting-consultation/

There are multiple technical committees at ISO that develop standards in each space of ESG, most of those standards are currently not reflected in the proposals put forward by various ESG frameworks developers (e.g. WEF, IFRS, SASB, GRI, Global Compact, UNCTAD ISAR, TCFD).

**2. Lack of guidance on the best ways to transform existing processes and operations to meet the indicators of various ESG frameworks**

**Challenge:** Companies are struggling to identify and implement what the best practices are to implement various ESG indicators. Such efforts include benchmarking practices and results within their sector.[14]

**Opportunities:** ISO's strength is in convening diverse stakeholders from both developed and developing countries to codify best practices into standards. Therefore, this is an area of opportunity for ISO to leverage its strengths to address an unmet need expressed by potential users.

Furthermore, ESG disclosure frameworks are horizontal in nature and touch on many aspects of businesses' interactions with their stakeholders. Therefore, their intersection with areas of standardization is wide. Particularly in the area of the environment, and increasingly in the areas of social realm and governance. It is important to align ESG disclosure frameworks with technical standards, to ensure alignment and that all incentives and efforts are directed in the same way towards the desired positive impacts on the environment and society. Mapping ISO standards to ESG frameworks can help users identify the tools needed to reach their ESG goals. Engagement with stakeholders in the ESG ecosystem and development of relationships and partnerships will be key to developing effective alignment and ensure that ISO standards support the users' needs.

**3. Lack of trust and stakeholder confidence in the ranking's results from the various frameworks and indices**

**Challenge:** Evaluation and comparability are challenging due to the lack of harmonization between the various frameworks, lack of consistent data, lack of consistent rating methodologies, and data governance practices.[15,16] For example, various rating agencies may rate the same company differently. This leads to confusion and distrust among investors and consumers (See Appendix I and II).

**Opportunity:** The ISO/CASCO Committee on Conformity Assessment has developed many tools to instill trust in markets and can offer solutions to address the needs of users in the ESG market. The ISO/CASCO toolbox could be leveraged to verify, demonstrate, and certify results which will increase trust in reporting and disclosure, as well as provide guidance on best practices and ways to continuously improve operations in response to ESG expectations.

[14] Story of Prod Inc. provides a user experience journey through the ESG reporting process (Appendix II)
[15] Boffo, R., and R. Patalano (2020), "ESG Investing: Practices, Progress and Challenges", OECD Paris, www.oecd.org/finance/ESG-Investing-Practices-Progress-and-Challenges.pdf
[16] Pucker, P. Kenneth (2021). "Overselling Sustainability Reporting". Harvard Business Review. https://hbr.org/2021/05/overselling-sustainability-reporting [accessed April 24, 2021]

## The Role of ISO

ISO is already a player in the ESG ecosystem. It has three key technical committees (TC) who develop standard to address ESG issues: ISO/TC 207 *Environmental management*, ISO/TC 322 *Sustainable finance*, ISO/TC 309 *Governance of organizations*, and potentially the new TC on Social Responsibility. These technical committees are already coordinating their work to ensure alignment. For example, ISO/TC 207 has several standards on green finance and works with ISO/TC 322 (it also collaborates with ISO/TC 323 on *Circular economy*). ISO/TC 322 also has a strong connection with ISO/TC 68 *Financial services.* ISO/TC 309 will have clear overlaps with the new potential ISO/TC on Social Responsibility. There are additional potential opportunities and linkages across other TCs that need to be further explored.

A vision and strategy to link the work of these technical committees to the global developments on ESG frameworks will help create synergies and value to users and stakeholders. One way to start this work is mapping indicators used in current ESG frameworks to ISO standards that address those indicators. Such a map can serve as a gap and opportunity analysis for next steps.

Due to the various touch points and value that ISO can complement the ESG ecosystem, its engagement with a broad range of stakeholders is critical to its continued relevancy in the environmental, social and governance standardization ecosystem. These challenges and opportunities require a clear vision and engagement strategy that are linked to the ISO 2030 Strategy, as well as coordination at the technical level to fully implement the engagement and standard alignment strategies in a concerted effort. Such a strategy could identify principles for engagement and desired outcomes, including how to align standard development with the needs if users while complementing the activities in the ecosystem. For example:

- Neutrality & agility
- Partnership driven
- Increased awareness about the link between production of goods and services to disclosure
- Increased awareness of the value the ISO process can bring (balanced representation, a UN-base body, WTO TBT, participation of developing countries & consumers)

## Next Steps

There is an opportunity for ISO to play a significant role in ensuring that the increasing significance of ESG frameworks has a positive impact beyond financial markets and is tied to a real change in production of products and services. The tools in the ISO/ CASCO toolbox can be better leveraged by the international community to further increase trust and value in ESG goals. In order to reap the benefits of such an opportunity, it is recommended that a Strategic Advisory Group (SAG) is established to advise ISO Technical Management Board (TMB) on how to best position ISO in the ESG ecosystem from a technical viewpoint and stakeholder engagement.

Due to the nature of the challenges, ISO's role and engagement in the ESG ecosystem requires coordination between its strategic priorities and direction of the technical work. Therefore, a SAG should consider intersection between the role of ISO Council of providing oversight and direction on strategic issues and TMB's role in providing strategic guidance on technical matters.

Given the cross-cutting nature of the topic of ESG and the level of risk associated with the status quo (i.e. relevancy of ISO standards), it is important that the structure of this work take the form of a SAG with strong direct links to ISO Council. This work needs to be completed quickly and requires the direct engagement of TMB members or their designated experts.

## Proposed SAG Mandate

The SAG will clarify and articulate ISO's vision and value proposition in the ESG ecosystem and propose next steps for ISO.

The SAG will include TMB members and their nominated experts from industry and will focus on developing a strategy and make a final report and recommendations for TMB approval.

The strategy could include the following activities:

1. Map the current ESG frameworks, standards, and indicators to ISO standards to identify alignment, gaps, and opportunities.
2. Articulate the value proposition that ISO brings to this ecosystem and how the ISO/CASCO toolbox can help solve some of the challenges in this space.
3. Map stakeholders in the ESG ecosystem.
4. Define and implement an experiment for a prototype of how users might leverage the ISO/CASCO toolbox to meet users' needs in the ESG ecosystem.
5. Develop a stakeholder engagement strategy to effectively collaborate with stakeholders in the ESG ecosystem at the technical and strategic policy level.
   5.1. The strategy shall identify clear roles and responsibilities within ISO and in relations to its membership,
6. Develop a mechanism to advise and monitor changes in the ESG operating environment and ensure those changes inform the ISO engagement strategy.
7. Provide advice on mechanisms to effectively coordinate the work of Technical Committees to ensure the standardization deliverables that are produced align with primary ESG disclosure frameworks/ regulators needs and the defined engagement strategy.
   7.1. Development of tools to support TCs who may have linkages to ESG considerations.

If you have questions regarding the proposal, you can contact:

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# Appendix I: Designing for Impact and Trust, ESG Value Chain & Link to Standardization

**International Standards**

**(Standards linked to disclosure indicators to inform how processes can consistently deliver desired impacts and continuously be improved)**

**The ISO/CASCO Toolbox:**

- **Certification of products, processes & services**
- **Certification of management systems**
- **Certification of people**
- **Verification and validation**

**ESG Disclosure Frameworks**

**Inform decision-making in capital markets and by regulators**

**Increase value**

**Restore & build trust**

**Capture an opportunity to harness the power of the market to have positive impacts**

# Appendix II: The Story of Prod inc., A Company's Journey in the ESG Ecosystem

Prod inc. wants to mitigate risk, uncover opportunities, be a good citizen & demonstrate responsibility to their stakeholders.

Prod inc. needs to consider over 10 ESG standards/ reporting frameworks/ indices. They also need to identify the ESG stakeholders that will be most impacted and areas most relevant to their operations and communities.

This requires disclosure on many indicators and is VERY burdensome

★ Challenge #1: Lack of harmonization and consensus in ESG frameworks

Prod inc.'s management wonders: How does ESG disclosure links to their

★ Challenge #2: Lack of guidance on how to transform existing processes and operations to meet the indicators of various ESG frameworks

Prod inc.'s Board of Directors' need to build its ESG competency to further build *trust between the Board and the management team*.

Prod inc. publishes an ESG report.

To highlight their progress on ESG performance, they make *claims* in the report.

Rating agencies *struggle* to evaluate Prod inc.'s performance against their industry peers since they all have their own methodology.

Prod inc. receives the rating results. Executive team is very *surprised*. There are discrepancies in the ratings.

★ Challenge #3: Lack of trust and stakeholder confidence in the ranking results from the various frameworks and indices

ESG-conscious consumers, investors & governments (procurement) of Prod inc. are rethinking their decisions, they start losing trust.

Prod inc.'s Board of Directors is concerned. Prod inc.'s investors & shareholders are *confused* and *concerned* because of the discrepancy in the ratings. The *trusting* relationship with management is shaken.

**Erosion of Value**

**Erosion of Trust & Confidence**

**Missed opportunity to harness the power of the market to create positive impacts**