Sustainable finance in emerging markets and the role of securities regulators

Consultation Report

The Growth and Emerging Markets Committee
OF THE
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

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Foreword

The Growth and Emerging Markets Committee (GEMC) of the International Organization of Securities Commissions (IOSCO) has published this Consultation Report with the aim of proposing a set of recommendations to assist growth and emerging markets (GEM) regulators in their efforts with regard to sustainable finance. The GEMC welcomes stakeholder views on its findings and recommendations. A final report will be prepared after consideration of comments received in response to this Consultation Report.

How to Submit Comments

Comments may be submitted by one of the three following methods **on or before 1 April 2019**. To help us process and review your comments more efficiently, please use only one method.

Important: All comments will be made available publicly, unless anonymity is specifically requested. Comments will be converted to PDF format and posted on the IOSCO website. Personal identifying information will not be edited from submissions.

1. Email

- Send comments to consultation-01-2019@iosco.org
- The subject line of your message must indicate '***Sustainable finance in emerging markets and the role of securities regulators***.'
- If you attach a document, indicate the software used (e.g., Microsoft WORD, ASCII text) to create the attachment.
- Do not submit attachments as HTML, PDF, GIFG, TIFF, PIF, ZIP or EXE files.

2. Facsimile Transmission

Send by facsimile transmission using the following fax number: + 34 (91) 555 93 68.

3. Paper

Send three (3) copies of your paper comment letter to:

Raluca Tircoci-Craciun
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

Your comment letter should indicate prominently that it is a '*Public Comment on* ***Sustainable financing in emerging markets and the role of securities regulators***.'

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Chapter 1 - Executive Summary

During the past several years, market participants, regulators and policy makers have increasingly focused their attention on issues concerning sustainable finance in its many forms. These issues are particularly relevant for growth and emerging markets as they seek to develop capital markets in their jurisdictions. Accordingly, in late 2017, IOSCO's Growth and Emerging Markets Committee (GEMC) initiated a project on *Sustainable finance in emerging markets and the role of securities regulators,* to help emerging markets regulators better understand the issues and challenges that affect the development of sustainable finance in capital markets.

At the same time, investors and asset managers are also seeking to better understand sustainability-related issues to ensure that capital is allocated according to investors' preferences. This Consultation Report explores the issues and challenges that affect the development of sustainable finance in capital markets, focusing on sustainable assets in emerging markets and measures to facilitate market development in this area.

This increasingly intense focus on global sustainability issues has been accompanied by growth in innovative sustainability-themed capital market products, such as green bonds, social-impact bonds, renewable energy investments and sustainable funds. In addition, industry has given growing importance to the disclosure of environmental, social and governance (ESG) risks, and now these risks are incorporated into their investment analysis and decision making.

Based on the GEMC analysis and discussions with market participants during a GEMC Dialogue on Sustainable Finance in Capital Markets (Dialogue) in London (July 2018), this Consultation Report proposes a set of 11 recommendations that member jurisdictions should consider when issuing regulations or guidance regarding sustainable instruments and additional disclosure requirements of ESG-specific risks. The proposed recommendations fall into the following categories:

- Integration by issuers and regulated entities of ESG-specific issues in their overall risk appetite and governance (Recommendation 1);
- ESG-specific disclosures and reporting (Recommendation 2);
- Data quality (Recommendation 3);
- Definition and taxonomy of sustainable instruments (Recommendation 4);
- Specific requirements regarding sustainable instruments (Recommendations 5 to 9);
- Integration of ESG-specific issues into the investment analysis, strategies and overall governance of institutional investors (Recommendation 10); and
- Building capacity and expertise for ESG issues (Recommendation 11).

The GEMC encourages its members to consider implementation of this guidance in the context of their legal and regulatory framework, given the significance of the associated risks and opportunities. The GEMC work complements IOSCO's efforts on sustainability such as the IOSCO Sustainable Finance Network and IOSCO's Statement on Disclosure of ESG Matters by Issuers that was issued in January 2019.

This Consultation Report is organized into six chapters. Following the Executive Summary, Chapter 2 provides the background of the GEMC project on sustainable finance. Chapter 3 includes an overview of the regulators' initiatives in emerging markets. Chapter 4 describes market trends and initiatives. Chapter 5 details the proposed GEMC recommendations (a list of the recommendations is found in the Appendix). Chapter 6 includes a list of specific questions that we encourage respondents to address.

Chapter 2 - Background

The agenda for global sustainability has advanced in recent years as policy makers and market participants increase efforts to promote financial markets that support long-term sustainable economic development, including socio-economic and environmental factors. Commentators have recognised the need to reorient financial markets to meet global sustainable development needs and deliver long-term and resilient growth. By 2050, the United Nations predicts that an additional 2.5 billion people will migrate from rural to urban areas, with nearly 90% of this increase concentrated in growth and emerging markets.[1] While cities and urban areas will offer important opportunities for economic development, they will also become increasingly vulnerable to the physical and transition risks posed by climate change.

Both the public and private sectors have made significant efforts to drive sustainable growth and long-term value creation. These efforts include increasing efficiency of markets and access to financing for sustainable development, developing sustainability-related principles and guidance to shape frameworks and enhancing financial reporting and disclosure to more effectively measure sustainability performance. Globally, securities regulators and exchanges have adopted policy measures to support the development of various aspects of sustainable finance, such as sustainable investment products, and raise the quality, transparency and visibility of information and data on sustainable finance.

These measures have led to substantial growth in sustainable investment products such as green bonds, social-impact bonds, renewable energy investments and sustainable funds, amongst others, and encouraged market participants to incorporate and disclose ESG risks. Exchanges have also launched initiatives to promote long-term market sustainability, such as developing ESG disclosure guidelines, carbon trading platforms and listings of ESG related indices, and encouraged companies to publish sustainability reports through both voluntary and mandatory mechanisms. In general, the use of integrated reporting and sustainability reporting is on the rise.

In February 2017, the IOSCO Board agreed that one of its Focus Areas for 2017-2018 would address *"analyzing the role of securities markets in capital-raising and sustainability issues, and the related role of securities regulation."* In line with the IOSCO Board´s Focus Areas, the GEMC agreed to review the key issues and challenges for developing sustainable capital markets and the role that securities regulators can play in this effort.

In October 2017, the GEMC established a Working Group on Sustainability in Emerging Markets (WGS) to carry out the work. The WGS is co-chaired by Marcos Ayerra, former GEMC Vice Chair and current Chair of the Inter-American Regional Committee and Chair of National Securities Commission (CNV) Argentina, and Syed Zaid Albar, Chairman of Securities Commission (SC) Malaysia and current Vice-chair of the GEMC. The members of the WGS include: CNV Argentina, SC Malaysia, CVM Brazil, CSRC China, DFSA Dubai, SEBI India and AMMC Morocco. The project aims to better understand the issues and challenges that have an impact on the development of sustainable finance in capital markets, focusing on sustainable assets in emerging markets and measures to facilitate progress in this area.

[1] United Nations, Department of Economic and Social Affairs, Population Division (2014). *World Urbanization Prospects: The 2014 Revision, Highlights* (ST/ESA/SER.A/352)

The WGS conducted a survey of GEMC members in November 2017 to collect information on the approaches and initiatives across member jurisdictions regarding sustainable finance and sought feedback on measures that can further drive or facilitate the development of sustainable capital markets. The survey responses showed that some jurisdictions have already taken steps to include sustainability factors on their regulatory agenda, and the responses indicated that a lack of accepted standards in this area is one of the main impediments for developing sustainable capital markets.

To complement the survey findings and to better inform its work, the GEMC held a *Dialogue on Sustainable Finance in Emerging Markets* in July 2018 in London. Participation at the Dialogue was widespread with 52 attendees including securities regulators, market practitioners and industry experts. The Dialogue discussed issues relating to the development of sustainable capital markets, different market-based instruments that can facilitate sustainable financing and the role of standardisation in this process. The discussions in London underscored the value of having the GEMC develop a set of recommendations to facilitate the development of sustainable finance, including sustainable instruments, in emerging capital markets.

Based on discussions within the GEMC, this Consultation Report presents a list of recommendations designed to foster transparency and disclosure for issuers related to products or instruments and to facilitate the development of sustainable finance, including sustainable products and instruments in emerging capital markets.

Chapter 3 - Overview of regulatory initiatives in emerging markets

Emerging markets are increasingly driving growth and innovation through a range of sustainable financing initiatives. While GEMC jurisdictions are at varying stages of progress in creating an enabling market environment for sustainable finance, nearly two-thirds of those surveyed reported having sustainability related initiatives in their jurisdictions. These initiatives relate to disclosure frameworks, incentive structures, public and private collaborations, data collection methods and external reviews and assessments. Further, there are also a growing number of sustainability-related products and instruments, including green and sustainable bonds, sustainable and responsible investment (SRI) funds and ESG indices. In this chapter, we highlight some of the major developments in various regions of the world. In some instances, as noted by the responses to the GEMC survey, regulators have taken measures based on the voluntary standards or guidance issued by various private sector groups. We include a reference to these initiatives in Chapter 4.

Asia

Asia has gained the most traction in terms of developing frameworks for sustainable finance with a particular focus on green bonds. This advantage stems from the region's large infrastructure financing requirements, currently estimated at $26 trillion, including the costs of climate mitigation and adaptation.[2]

China remains one of the most active jurisdictions in Asia for sustainable finance. It is also the world's second largest green bond market.[3] In March 2017, the China Securities Regulatory Commission (CSRC) issued its Guidance for Supporting Green Bond Development, which prescribes standards and requirements, as well as policy initiatives for green corporate bonds. The guidance mandates periodic disclosure of information relating to the use of proceeds, progress of the green projects and their environmental benefit. By December 2017, China's pilot green bond programme successfully facilitated the issuance of 48 green corporate bonds and green asset-backed securities (ABS) on the exchange-traded market, raising a total of RMB 53.749 billion. In 2016, the People's Bank of China (PBoC), along with six other government agencies including the CSRC, issued Guidelines for Establishing the Green Financial System. The guidelines review the role of the securities market in supporting green investment. They recommend improvements in the rules and regulations for green bonds, reductions in the financing costs of green bonds, the formulation of standards for third-party verification of green bonds and green credit ratings, support for the development of green bond indexes, green equity indexes and related products and encouragement for institutional investors such as pension and insurance funds to make green investments.

In December 2017, PBoC and CSRC released their Guidelines on Green Bond Certification. Their aim is to harmonise the standards used in the certification process and to ensure that issued bonds continue to comply with relevant green bond standards and requirements.

The CSRC, in collaboration with China's Ministry of Ecology and Environment (previously the Ministry of Environmental Protection), plans for all listed companies to disclose, by 2020, the environmental risks associated with their operations. Currently, China has an

[2] https://www.adb.org/sites/default/files/publication/227496/special-report-infrastructure.pdf

[3] China currently accounts for 15% of global green bond issuance, according to data from the Climate Bonds Initiative. See https://www.climatebonds.net/files/reports/china_annual_report_2017_en_final_14_02_2018.pdf

environmental disclosure mechanism for green corporate bonds. Next, the CSRC will look further into applying the environmental disclosure requirements to all bond issuers. These standards include requirements for companies to report on relevant ESG matters. The requirements are mandatory for key polluters and apply on a comply-or-explain basis for all other listed companies, although these requirements will become mandatory for all listed companies in 2020. The Guidelines for Establishing the Green Financial System encourage securities regulators to increase the penalties for listed enterprises and bond issuers that falsify environmental information.[4]

In India, following SEBI's endorsement of the International Capital Market Association (ICMA)'s Green Bond Principles (GBP) in 2015, SEBI sought to formalise its regulatory framework through the issuance of the Green Bond Guidelines in May 2017. The guidelines institute disclosure norms for issuing and listing green bonds, with mandatory requirements for continuous disclosure and monitoring, as well as optional measures addressing the appointment of independent third-party reviewers for pre- and post-issuance certification and validation. In August 2012, SEBI also introduced mandatory requirements for the top 100 companies (by market capitalisation) listed on India's two main stock exchanges to publish Business Responsibility Reports in their annual reports. In December 2015, the scope was extended to the top 500 companies. The structure of the Business Responsibility Report is based on nine principles specified by SEBI, relating to issues such as business ethics, employee well-being, stakeholders, human rights, environmental protection and consumer responsibility.

Given the alignment of Shariah investing with sustainable finance, Malaysia has been focusing efforts to further develop the SRI ecosystem while leveraging on the jurisdiction's leadership in Islamic finance. With 30% market share of sustainable investment assets in Asia, Malaysia is the largest sustainable investment market in the region (ex-Japan).[5] Key efforts by SC Malaysia include the development of the SRI Sukuk Framework to finance Shariah-compliant green, social and sustainable projects in 2014. This helped to pave the way for the issuance of the world's first green sukuk in July 2017 to finance a solar power project. Equally important to the success of Malaysia's sustainability framework has been the introduction of a variety of incentives to promote sustainable asset classes, such as those under the SRI Sukuk Framework, whereby issuers are eligible for tax deductions and grants to offset the external review costs incurred in the issuance of green sukuk. Since the introduction of the framework, five green SRI sukuk have been issued, bringing total issuance size to RM 2.4 billion (approximately US$584 million). In addition, one social impact sukuk programme with a total approved size of RM 1.0 billion (approximately US$243.4 million) has been issued under this Framework.[6] Further, in 2017, SC Malaysia also introduced Guidelines on SRI Funds in an effort to widen the range of SRI products and facilitate the growth of SRI funds in the country. SC Malaysia has also organised various capacity-building programmes and international conferences to develop greater market understanding of sustainable finance.

Prior to this, in 2014, SC Malaysia and the Minority Shareholder Watchdog Group launched the Malaysian Code for Institutional Investors, a code and set of best practices collectively developed by Malaysia's largest institutional investors. The Code sets out broad principles of effective stewardship for institutional investors, including the disclosure of stewardship

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4 SSE initiative (2018) "How securities regulators can support the Sustainable Development Goals, a sharing of experienced,"

5 Global Sustainable Investment Review 2016

6 Two tranches of RM100 million each have been issued in 2015 and 2017 respectively

policies, the monitoring of and engagement with investee companies and the management of conflicts of interest. Principle 5 of the code encourages institutional investors to incorporate corporate governance and sustainability considerations into their investment analysis and decision-making process and to develop a policy on how to achieve this objective.

In 2015, the exchange, Bursa Malaysia introduced amendments to its listing requirements to include sustainability-related matters, including disclosure on material economic, environmental and social risks and opportunities. The exchange subsequently issued a Sustainability Reporting Guide to aid listed issuers in embedding sustainability consideration in their respective entities and reporting on it.

Within the Association of South East Asian Nations (ASEAN), the ASEAN Capital Markets Forum (ACMF), the grouping of securities regulators from 10 ASEAN jurisdictions,[7] introduced the ASEAN Green Bond Standards in November 2017.[8] The ACMF also recently developed the ASEAN Social Bond Standards for financing projects that are socially beneficial. Further, it developed the ASEAN Sustainability Bond Standards for financing a combination of both green and social projects that offer environmental and social benefits. These standards were introduced by the ACMF to create sustainable asset classes in ASEAN and to meet the region's infrastructure and social development financing needs.[9]

Inter-America

Many jurisdictions in the Inter-American region are at the forefront of developing sustainable capital markets. Across the region, an increasingly deep and diversified green bond market is taking shape. At the same time, these jurisdictions are focusing on instituting clear and transparent disclosure standards for non-financial reporting. This has been crucial in creating an enabling environment for sustainable finance at a time when the International Finance Corporation (IFC) estimates that more than US$1 trillion in climate financing opportunities will arise in Latin America and the Caribbean up to 2040.[10]

In this respect, Mexico has led the way in sustainable finance, with the issuance of the first Latin American bond to gain Climate Bond Certification by the Climate Bonds Standard Board in 2015.[11] Mexico City also has the distinction of issuing the first green Latin American municipal bond to fund climate-resilient infrastructure and mobility projects. Brazil has also taken several important steps towards establishing a framework for sustainable finance. Following Brazil's ratification of the Paris Agreement in September 2016, it launched its voluntary Green Bond Guidelines, jointly developed by the Brazilian Federation of Banks (FEBRABAN) and the Brazilian Business Council for Sustainable Development (CEBDS). Brazil also saw the establishment of its first green energy fund in 2016 by the Brazilian

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[7] Brunei Darussalam, Cambodia, Indonesia, Laos PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam

[8] In 2018, following ICMA's issuance of its Green Bond Principles, the ASEAN Green Bond Standards were revised in October to ensure alignment with ICMA's Green Bond Principles.

[9] The ASEAN Green Bond Standards, the ASEAN Sustainability Bond Standards and the ASEAN Social Bond Standards are based on ICMA's Green Bond Standards, Sustainability Bond Guidelines and Social Bond Principles respectively.

[10] https://www.ifc.org/wps/wcm/connect/0d9f8fbf-2738-4432-843c-05184b9546d8/LAC+1Trillion+6-13-16+web+FINAL.pdf?MOD=AJPERES

[11] https://www.climatebonds.net/resources/press-releases/climate-bonds-welcomes-first-mexican-green-bond

Development Bank (BNDES). Its voluntary Corporate Governance Code has been a key driver behind the growth of sustainable finance in the country. Published in 2015, the code has a "comply or explain" model that has been instrumental in encouraging listed companies to incorporate ESG factors into their business strategies.

In Brazil in 2017, the Laboratory of Financial Innovation (LAB) was established to bring public and private entities together to create and develop financial instruments and initiatives focused on sustainable development. The initiative is led by the Inter-American Development Bank in partnership with the Brazilian Securities and Exchange Commission (CVM) and the Brazilian Development Association. The LAB has organised its working groups around four main themes: green bonds; green finance; financial instruments for social impact; and fintech. In 2018, Central Bank of Brazil introduced new regulations requiring local pension funds to consider ESG factors, whenever possible— an extension of the previous rule, introduced in 2009, that required the funds´ investment policies to mention if principles of environmental and social responsibility had been considered.[12]

Similarly, Argentina and Chile have both sought to improve the standard of non-financial reporting with the introduction of "comply or explain" models for sustainability related disclosures. In both markets, national financial reporting, accounting and auditing standards are benchmarked against international standards, such as The Global Reporting Initiative (GRI). In Argentina, the Professional Council in Economic Sciences of Argentina (FACPCE) established specific criteria for the preparation and presentation of the Social Balance, benchmarked against the GRI's Sustainability Reporting Guidelines. Additionally, in September 2018, Argentina's Securities and Exchange Commission (the CNV) launched its Green, Social and Sustainable Guidelines through a public consultation process. At this time, the consultation has reached its last stage, and the guidelines will be officially approved very soon. The Guidelines aim to offer both the market and potential issuers a set of good practices and standards aligned with the best international criteria, to foster the development of social, sustainable and green emissions. In 2015, the Chilean Comisión para el Mercado Financiero (CMF)issued rules for the disclosure of information related to corporate governance practices by listed companies. The disclosure rules are similarly benchmarked against international standards, e.g., ISO 26000:2010 and IIRC's disclosure principles, and place added emphasis on embedding socially responsible practices into a company's decision making. The reporting of ESG issues by issuers of securities in Chile has been approached in two different ways. First, by establishing requirements for the exchange-traded companies to explain, on an annual basis, whether they are adopting the corporate governance practices related to ESG issues (provided for in the rules regarding operation, organization and training of directors; management of risks including those related to sustainability; and drafting and dissemination of reports, using GRI and other standards). Second, by imposing the obligation of providing, in the Annual Report, information on salary gaps and diversity in a separate section named Sustainability. Both regulations are currently under review in order to progress in the adoption of best practices in the reporting of ESG matters.

Europe

Many regulatory initiatives taken by European jurisdictions have arisen from a close collaboration with other key sustainability stakeholders. European respondents to the GEMC survey often highlighted sustainability initiatives led by other stakeholders, e.g., the

[12] SSE initiative (2018) "How securities regulators can support the Sustainable Development Goals, a sharing of experienced,"

government and stock exchange. For example, Poland's inaugural green bond issuance in 2016 (the first sovereign issuance in the world) underscored the government's commitment to fulfilling its environmental goals and obligations in the National Renewable Energy Action Plan.

Turkey's stock exchange has similarly been a driving force for promoting sustainable finance. In 2014, Borsa Istanbul launched the BIST Sustainability Index to provide a benchmark for listed companies with high corporate sustainability ratings. The index also serves as a platform for institutional investors to demonstrate their commitment to companies who successfully manage ESG issues.

The members of the Turkish Sustainability Platform, which was launched in 2013, include the Capital Markets Board of Turkey, Borsa Istanbul, industry associations and non-governmental organisations. The aim of the platform is to create a multi-stakeholder network to facilitate joint sustainability activities and discussions on future collaboration in the field of sustainability. The platform works to increase awareness and knowledge regarding sustainability. It supports efforts to ensure that sustainability issues are included in relevant legislation and regulations, promotes sustainability practices and enables collaboration with related international agencies. In 2014, the Turkish Capital Markets Board (CMB) introduced revisions to the Corporate Governance Principles, asking listed companies to provide information in their annual reports on social rights, in-house training, health and safety, corporate social responsibility initiatives and social and environmental performance. To support the implementation of the principles, the CMB and the European Bank for Reconstruction and Development (EBRD) are developing an online corporate governance reporting framework. The framework will also encourage companies to provide additional information on their ESG-related practices and performance.

At the end of 2016, the European Commission (EC) appointed the High-Level Expert Group on Sustainable Finance (HLEG) to obtain advice on how to integrate sustainable finance into financial market regulation. The HLEG delivered its final report in January 2018. Based on the HLEG's final report, the Commission adopted the Action Plan on sustainable finance in March 2018 which sets out an EU strategy for sustainable finance. The EC adopted a package of measures implementing several key actions announced in its Action Plan. This includes a proposal for a regulation on the establishment of a framework to facilitate sustainable investment; a proposal for a regulation on disclosures relating to sustainable investments and sustainability risks; and a proposal for a regulation amending the benchmark regulation.[13] The EC has established a Technical Expert Group on Sustainable Finance to assist it in developing a unified classification system for sustainable economic activities, an EU green bond standard, methodologies for low-carbon indices, and metrics for climate-related disclosure. In addition, from 24 May to 21 June 2018, the EC sought feedback on amendments to delegated acts under the Markets in Financial Instruments Directive (MiFID II) and the Insurance Distribution Directive to include ESG considerations into the advice that investment firms and insurance distributors offer to individual clients.

Africa and Middle East

A number of important regulatory initiatives have taken shape across this region. In 2016, Morocco launched the Financial Sector Roadmap for Climate Change, in conjunction with the Moroccan presidency of the 22nd session of the Conference of Parties (COP 22). As a first step

[13] https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en

towards meeting the roadmap's specific commitments, the Moroccan Capital Market Authority (AMMC) published the Green Bonds Guidelines in 2016, in consultation with the IFC. In 2018, the AMMC issued new guidelines on green, social and sustainable bonds. The guidelines provide an overview of the principles that issuers need to comply with, and provide guidance on the actions to be taken to have these bonds certified.

This move helped facilitate the issuance of five green bonds (totalling US$420 million) to finance renewable energy and energy efficiency projects. The roadmap also commits Morocco to pursue greater regional cooperation in developing green capital markets. As a result of this regional commitment, the AMMC, along with 20 other regulators and exchanges, initiated the Marrakech Pledge for Fostering Green Capital Markets in Africa (there are 26 signatories to the Pledge at this time).[14] This continental coalition of African capital markets and exchanges aims to realign capital markets with climate change commitments by extending risk-based governance to socio-environmental risks and developing sustainable financial instruments and products. Capacity building is one of the five pillars of the 2016 Roadmap for aligning the Moroccan financial sector with sustainable development. In 2018, the Moroccan Capital Market Authority included a module on sustainable finance in its professionals' licensing framework. As one of the commitments under the 2016 roadmap for aligning the Moroccan financial sector with sustainable development, the AMMC has launched a public consultation regarding the rules governing the disclosure requirements of publicly traded companies should evolve to integrate sustainability-related information. The AMMC has also authorized 2 SRI funds and assisted the Casablanca stock exchange on the process of creating an ESG index to create a valid benchmark for Responsible investment strategies.

In respect of Kenya, the jurisdiction does not distinguish sustainable asset classes from other investment asset classes. The Kenyan Capital Markets Act and the Capital Markets Regulations provide the regulatory framework for issuance of all asset class investments. Nevertheless, the Capital Markets Authority (CMA) Kenya is in the midst of developing the Kenya Green Bonds Guidelines, in collaboration with the Nairobi Securities Exchange, Climate Bonds Initiatives, Kenya Bankers Association, Financial Sector Deepening Africa, Dutch Development Bank FMO and IFC.

The Institute of Certified Public Secretaries of Kenya, the CMA and the International Finance Corporation held workshops for accredited governance auditors to facilitate the implementation of the Code of Corporate Governance Practices for Issuers of Securities to the Public, issued in 2015. The CMA also provided training to board members of listed companies on the Kenyan Corporate Governance and Stewardship Codes, both of which explicitly identify social and environmental issues as within the code's scope.

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14 http://marrakechpledge.com/aligning-africa/country-specific-initiatives-morocco/

Chapter 4 – Market trends and initiatives

As sustainability issues affect both the financial markets and market participants (albeit in different ways), they pose risks but also create opportunities. In recent years, sustainability has become a significant issue for an increasing number of market participants as well as for regulators and policy makers.

The current state of development funding shows a stark contrast between the estimated cost of financing the Sustainable Development Goals (SDGs) through 2030 and the available financial resources. The United Nations Conference on Trade and Development (UNCTAD) says achieving the SDGs will cost between US$5 and $7 trillion annually, with an investment gap in developing countries of about US$2.5 trillion.[15]

As the GEMC Dialogue highlighted, this significant funding gap between the capital needed to implement SDGs and what governments can provide creates an opportunity for markets. Asset owners, including large public and private pension funds, are leading the way with specific stewardship requirements and mandates for sustainable investments. The discussions at the GEMC Dialogue with market participants emphasized that investors want issuers to clearly demonstrate how they integrate long-term sustainable thinking into their investment decisions.

An increasing number of institutional investors are committed to incorporating ESG factors into their investment analysis and decision-making processes. At the end of April 2017, for example, more than 1,700 asset managers and pension funds, representing nearly US$70 trillion in assets under management,[16]had signed the UN-backed Principles for Responsible Investment (PRI). In addition, the Climate Bonds Initiative (CBI)[17] identified the top twenty underwriters of green bonds for Q1 2018, many of which include top financial firms.

Recent studies also show that retail investors are increasingly interested in fostering sustainable markets. Morgan Stanley Institute for Sustainable Investing conducted a survey in 2017 with more than 1000 retail investors and the results showed that *"[…] three-quarters reported an interest in sustainable investing. Millennial investors continue to lead the change. They are twice as likely as the overall pool to invest in companies or funds that target social or environmental outcomes."*[18]

At the same time, the market for sustainable instruments, particularly green bonds, has developed steadily over the last five years. The Q1 2018 Green Bonds Market Summary published by the CBI[19] states that 71 green bonds were issued by 52 issuers in Q1 2018, for a total of US$25.8 billion. Of this amount, US$8.4 billion were issued in emerging markets, which now account for 32% of the quarterly issuance, compared to just 15% in Q1 2017. The same publication states that the total issuance for 2018 is estimated at US$250 billion, which

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15 https://unctad.org/en/Pages/Home.aspx

16 https://www.unpri.org/pri/about-the-pri

17 https://www.climatebonds.net/files/reports/q1_2018_highlights_final.pdf

18 https://www.morganstanley.com/pub/content/dam/msdotcom/ideas/sustainable-signals/pdf/Sustainable_Signals_Whitepaper.pdf

19 https://www.climatebonds.net/2018/04/q1-2018-green-bonds-market-summary-usd258bn-preliminary-quarterly-figures-2017-annual

would exceed the record US$155 billion of green bonds issued in 2017, and the volume of issues is expected to increase further.

At the industry level, various associations have led sustainability-related initiatives. We have included several examples below, acknowledging that there have been other initiatives as well.

For example, various associations have issued voluntary standards relating to sustainable instruments. This includes, amongst others, the Green Bond Principles issued by the ICMA, the ASEAN Green Bond Standards, the ASEAN Social Bond Standards and the ASEAN Sustainability Bond Standards issued by the ACMF, the Climate Bonds Standards issued by the Climate Bonds Initiative (CBI) and the Green Loan Principles (GLP) issued by the Loan Market Association (LMA).

Regarding disclosure requirements, a series of initiatives gave rise to the issuance of voluntary standards. For example, the Task Force on Climate-related Financial Disclosures (TCFD) developed a set of voluntary, consistent disclosure recommendations for companies providing information to investors, lenders and insurance underwriters about their climate-related financial risks. The Global Reporting Initiative (GRI) launched its Sustainability Reporting Standards (GRI Standards) for sustainability reporting, in October 2016. In 2015, the International Integrated Reporting Council (IIRC) issued the International Integrated Reporting Framework, which aims to accelerate the adoption of integrated reporting across the world. The Sustainability Accounting Standards Board issued in November 2018 a set of 77 industry-specific standards to assist companies in disclosing useful and financially-material sustainability information to investors. In addition to voluntary disclosure practices, the number of markets with mandatory requirements for ESG data disclosure has also risen, from four markets in 2012 to 16 markets in 2018.[20]

A group of institutional investors developed a set of Principles for Responsible Investment (PRI) for the purpose of incorporating ESG issues into investment practice.

At the stock exchanges level, several recent initiatives gained momentum in the course of 2018. For example, the United Nations Sustainable Stock Exchanges (SSE) initiative has approximately 80[21] partner stock exchanges that are committed to promoting sustainable and transparent capital markets. In 2018, the SSE issued its biennial Report on Progress, which provides data on trends in the sustainability-related activities of stock exchanges. It also issued a report that examines how, within their existing mandates, securities regulators could respond or are responding to sustainability-related risks and opportunities. Additionally, the World Federation of Exchanges (WFE) issued in 2018 its Sustainability Principles and updated its initial report on Exchange Guidance and Metrics, which identifies specific metrics exchanges may wish to encourage companies to disclose as baseline indicators.

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[20] http://www.sseinitiative.org/data/

[21] http://www.sseinitiative.org/sse-partner-exchanges/

Chapter 5 – Proposed GEMC Recommendations

The GEMC survey results indicate that several securities regulators in emerging markets have already taken steps to adopt specific regulatory frameworks for sustainable finance. The fundamental goal of such frameworks is to foster transparency and disclosure of key risks related to issuers and products or instruments as well as to facilitate the development of sustainable finance, including sustainable products and instruments in emerging capital markets.

Despite these developments, both the survey results and the GEMC Dialogue indicated that specific recommendations from the GEMC could further help facilitate the development of sustainable finance, including sustainable products and instruments in emerging capital markets, such as green bonds, social impact bonds and ESG funds in emerging capital markets. In this regard, the GEMC has identified the pre-requisites for creating an ecosystem that facilitates sustainable finance in capital markets. Critical components include such things as an appropriate regulatory framework, fit for purpose market infrastructure, reporting and disclosure requirements, governance and investor protection guidelines and mechanisms to address needs and requirements of institutional investors.

This section contains the proposed list of recommendations that GEMC member jurisdictions should consider when issuing regulations or guidance regarding sustainable products and instruments and additional disclosure requirements of ESG-specific risks.

In proposing this set of recommendations, the GEMC believes they will help achieve a degree of international consistency and harmonisation and thereby assist investors and issuers, given the cross-border and global nature of sustainable instruments. The proposed recommendations take into consideration the IOSCO Principles and Methodology,[22] including:

- Principle 16 (for issuers) which requires consideration of the adequacy, accuracy and timeliness of both financial and non-financial disclosures as well as disclosure of risks that are material to investors decisions;

- Principle 26 (for collective investment schemes - CIS) which requires that all matters material to the valuation of a CIS are disclosed to investors and potential investors on a timely basis.

The proposed recommendations related to sustainable instruments also take into consideration the main elements identified by a number of public and private sector groups. In line with IOSCO Principles 16 and 26 requirements, GEMC members should also consider whether additional disclosure requirements are needed with regard to the ESG risks and opportunities related to governance, strategy and risk management of an issuer or CIS. In addition, the recommendations also cover requirements for institutional investors and for building capacity and expertise for ESG issues.

The full list of proposed recommendations is included in the Appendix to this Consultation Report.

[22] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD562.pdf

Recommendation 1: Integrating ESG-specific issues in overall risk appetite and governance. Issuers and other regulated entities should integrate ESG-specific issues, where these are material, in the overall risk appetite and governance of these entities.

Recommendation 1 aims to promote the integration of ESG-specific issues into the overall risk appetite and governance of issuers and other regulated entities. Among other things, this will enable ESG-specific issues to receive attention of the board. It will also promote the development of sustainable investments and contribute to a more sustainable economy.

Many initiatives indicate corporate governance is fundamental to ensuring sustainable performance of companies. While issues such as board structure and leadership, executive remuneration and reporting remain of high importance, the focus of corporate governance discussions have expanded in recent years. Much greater attention is now given to the responsibilities of boards for the environmental and social performance of their companies. However, due to short-term market pressures, issuers and other regulated entities often focus on short-term financial performance and pay less attention to the opportunities and risks generated from ESG-specific issues.

There has been increased emphasis recently on the need for longer-term investment for a number of reasons, including financial stability. ESG considerations are almost by definition longer term in nature, and therefore align well with the focus on long-termism. In the last few years, institutional investors and companies have started to look at a series of environmental and social factors which they view as critical and material to the long-term financial health of the company. As ESG factors affect different aspects of a company's business, from financial performance to risk management, recent studies[23] show that incorporating those ESG factors into the business is becoming integral to a company's long-term viability. These studies also show that institutional investors and companies have also started to use materiality assessments to define those ESG issues that matter most to their businesses and stakeholders on a long term.

Recommendation 2: ESG-specific disclosures and reporting. Regulators should require disclosure with regard to material ESG-specific risks (including transition risks) and opportunities in relation to governance, strategy and risk management[24] of an issuer or CIS. This information should be part of the overall disclosure that the issuer or CIS makes under Principle 16 or 26.

Recommendation 3: Data quality. Where regulators determine that additional ESG-specific reporting is needed (in accordance with Recommendation 2), regulators should aim to ensure adequate data quality for ESG-specific reporting, including, among others, through updating listing rules, the use of external reviews and through the operation of other information service providers e.g. credit rating agencies (CRAs), benchmarks and auditors.

Recommendations 2 and 3 refer to the ESG-specific disclosures and data quality for issuers and CIS. As also indicated in the GEMC survey findings and GEMC Dialogue held in July 2018, the lack of accepted standards is one of the main impediments for the development of sustainable capital markets. There is therefore a need for sustainability frameworks and consistent taxonomies to be implemented with a focus on quality of disclosures. Clear,

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23 https://assets.kpmg/content/dam/kpmg/lu/pdf/lu-en-esg-strategy-framework-for-board-oversight.pdf

24 This could include the use of scenario analysis in the context of the recommendations made by the Task Force on Climate-related Financial Disclosures (TCFD).

consistent and comparable data is necessary for investors to take proper investment decisions. These recommendations intend to assist in enhancing transparency of ESG-specific risks and opportunities by establishing disclosure requirements for ESG-specific issues and taking actions to ensure adequate data quality for ESG-specific reporting.

ESG-related disclosures, particularly the reporting of environmental information emphasizing climate-related disclosure, is one area of priority in several emerging market jurisdictions. Institutional investors are becoming increasingly concerned about the impact of climate change risks and opportunities on investment returns. Despite demand from institutional investors for greater clarity and transparency, the quality of ESG disclosures has been an issue. Deficiencies in disclosure may also be intensified by the lack of mandatory ESG disclosure requirements in some jurisdictions. In addition to the quality of disclosure, ESG disclosure lacks comparability and there are significant differences between local requirements in different jurisdictions. At the international level, there are several initiatives which cover ESG disclosure requirements.

Recommendation 4: Definition of sustainable instruments. Sustainable instruments should be clearly defined and should refer to the categories of eligible projects and assets that the funds raised through their issuance can be used for.

Recommendation 5: Eligible projects and activities. Funds raised through sustainable instruments should be used for projects and activities falling under one or a combination of the broad ESG categories listed below:

- Environmental (renewable resources; combatting/mitigating climate change; pollution and waste; and other environmental opportunities);
- Social (human capital; product liability; and other social opportunities);
- Governance (corporate governance; corporate behaviour).

It will be up to each GEMC member to define the list of eligible projects and activities for their jurisdictions, taking into account that an eligible project or activity cannot, at the same time, do any significant harm to any other ESG categories.

Recommendation 6: Offering document requirements. Regulators should establish requirements for the offerings of sustainable instruments including, amongst others, the use and management of the funds raised through the issuance of such instruments, and the processes used by issuers for project evaluation and selection.

Recommendation 7: Ongoing disclosure requirements. Regulators should establish ongoing disclosure requirements regarding the use of the funds raised through the issuance of sustainable instruments including the extent of unutilized funds, if any.

Recommendation 8: Proper use of funds. Regulation should provide for measures to prevent, detect and sanction the misuse of the funds raised through the issuance of sustainable instruments.

Recommendation 9: External reviews. Issuers should consider the use of external reviews to ensure consistency with the definition of the sustainable instruments as provided in Recommendation 4.

Recommendations 4 to 9 refer to sustainable instruments which may include green, social and sustainable bonds, green asset backed securities, as well as green Exchange Traded Funds and ESG funds, among others. These recommendations aim to promote integrity in the development of the sustainable instruments market, consisting of the four core components, (1) definition and eligible projects, (2) offering and ongoing disclosure requirements, (3) proper use of funds, and (4) external reviews. While the issuance of sustainable instruments has grown rapidly in emerging markets, a lack of investor demand continues to be one of the main impediments for developing sustainable capital markets. Increasing trust in sustainable instruments will facilitate channelling more investments into sustainable instruments and contribute to the development of sustainable capital markets in many emerging markets. The existing globally recognised disclosure standards could be referenced when regulators develop disclosure requirements in their jurisdiction.

Recommendation 10: Institutional investors. Consistent with their fiduciary duties, institutional investors, including asset managers and asset owners, should incorporate ESG-specific issues into their investment analysis, strategies and overall governance, and take into account material ESG disclosures of the entities in which they invest.

Recommendation 10 refers to institutional investors. As mentioned above, more than 1,700 institutional investors have signed the PRI and are committed to incorporating the ESG-specific issues into their investment analysis and strategies. However, most of these institutional investors are from developed markets and there is no specific framework in emerging markets to encourage institutional investors to incorporate ESG-specific issues into their analysis and decision-making. This Recommendation would further help the development of sustainable investments once institutional investors begin to incorporate ESG-specific issues into their investment analysis, strategies and overall governance, and take into account ESG disclosures of the entities in which they invest.

Recommendation 11: Building capacity and expertise for ESG issues. Regulators should analyse the gaps in capacity and expertise with regard to ESG-related issues mentioned in the above recommendations and consider targeted capacity building to address these gaps. Regulators should also have appropriate monitoring mechanisms in place to encourage application of these recommendations.

Recommendation 11 refers to building capacity of regulators and market participants with regard to ESG-related issues. As described above, the GEMC survey results signal the lack of understanding and awareness of sustainable finance issues amongst regulators and market participants as an impediment for developing sustainable finance markets. Regulators should work to build an understanding of the impact of ESG investment on long-term financial performance and its social or environmental impacts alongside their financial returns. In addition, regulators should have mechanisms to monitor implementation of the recommendations in this report. This Recommendation would help market participants understand the importance of ESG investment and develop the supply of the sustainable instruments and the demand from retail investors and institutional investors in emerging markets.

Chapter 6 – Questions for respondents

To assist in developing the GEMC final report on sustainable finance, respondents are encouraged to answer the following questions in their submissions:

Questions relating to the (Recommendation 1)

1. Do you agree that it is important to include a general recommendation regarding the need for issuers and other regulated entities to integrate ESG-specific issuers in the overall risk appetite and governance?

2. Do you have specific comments on the proposed Recommendation 1?

Questions relating to ESG-specific disclosures and reporting, and data quality (Recommendations 2 and 3)

3. Do you have specific comments on the proposed recommendation for ESG-specific disclosures and reporting?

4. Do you agree that a separate recommendation on data quality is needed? Do you have specific comments on the proposed recommendation?

Questions relating to sustainable instruments (Recommendations 4 to 9)

5. Do you agree that this set of recommendations should be applicable to all sustainable instruments, and not only debt instruments?

6. Do you have specific comments on the proposed recommendation relating to the definition and taxonomy of sustainable instruments?

7. Do you agree with how eligible projects have been framed in recommendation 5?

8. Do you agree that it is useful to have separate recommendations for offering document requirements and for ongoing disclosure requirements, respectively? Do you have specific comments with regard to these recommendations?

9. Do you agree that regulators should provide for measures to prevent, detect and sanction misuse of funds raised through the issuance of sustainable instruments?

10. Do you agree with the recommendation relating to external reviews? Do you think that such external reviews should be mandatory or voluntary?

Questions relating to institutional investors (Recommendation 10)

11. Do you agree that it is important to have a specific recommendation with regard to institutional investors?

12. Do you agree that regulators should consider asking institutional investors to incorporate ESG-specific issues into their investment analysis, strategies and overall governance?

13. Do you agree that regulators should ask the institutional investors to take into account ESG disclosures of the entities in which they invest?

Questions relating to capacity building (Recommendation 11)

14. Do you agree that it is important to have a specific recommendation relating to capacity building?

15. Do you also agree that this recommendation should apply both to regulators and market participants?

Appendix – List of Recommendations

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