Sustainable finance in emerging markets and the role of securities regulators

Final Report

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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 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.

For the purposes of this report, the terms "sustainability" and "ESG" (Environmental, Social and Governance) are used interchangeably. This report covers all three dimensions of ESG -- environmental (including climate change), social and governance -- focusing on the risks that may have an impact on the financial system and the need for appropriate transparency and disclosures 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 report sets forth a set of ten recommendations that member jurisdictions should consider when issuing regulations or guidance regarding sustainable instruments and additional disclosure requirements of ESG-specific risks. The recommendations fall into the following categories:

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

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 report is organized into five 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 GEMC recommendations (a list of the recommendations is found in the Appendix).

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 recognized 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.

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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 standardization 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.

The GEMC has also considered the responses to the *GEMC Consultation Report on Sustainable finance in emerging markets and the role of securities regulators* published on 1 February 2019 and found at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD621.pdf.

Based on discussions within the GEMC, this 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 program 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 harmonize 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 environmental disclosure mechanism for green corporate bonds. Next, the CSRC will look further into applying the environmental disclosure requirements to all bond issuers. These

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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

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 formalize 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 capitalization) 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. 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 deduction 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) as at 2018. In addition, one social impact sukuk programs with a total approved size of RM 1.0 billion (approximately US$243.4 million) has been issued under this Framework.[5] 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 organized various capacity-building programs 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 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.

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

5 Two tranches of RM100 million each were issued in 2015 and 2017, respectively

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 considerations 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,[6] introduced the ASEAN Green Bond Standards in November 2017.[7] In 2018, the ACMF also 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.[8]

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.[9]

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.[10] 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 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.

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6 Brunei Darussalam, Cambodia, Indonesia, Laos PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.

7 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.

8 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.

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

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

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 organized 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.[11]

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. During 2017 and 2018, two banks (Banco Galicia and Banco BICE) as well as two provinces (Jujuy and La Rioja) issued green bonds, purchased by international investors, International Finance Corporation (IFC) and Inter-American Development Bank (IDB), for a total amount of $540 million. In March 2019, Argentina's Securities and Exchange Commission (the CNV) issued its Green, Social and Sustainable Guidelines 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. Additionally, in 2018 the CNV approved and ESG rating methodology, and a local stock exchange (BYMA) launched a sustainability index. BYMA is also planning to launch a market trading segment for products complying with the CNV guidelines in the near future. 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 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

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[11] SSE initiative (2018) "*How securities regulators can support the Sustainable Development Goals, a sharing of experiences*."

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 organizations. 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 a European Union (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.[12] The EC has established a Technical Expert Group on Sustainable Finance (TEG) to assist it in developing a unified classification system for sustainable economic activities (EU taxonomy), an EU green bond standard, methodologies for low-carbon indices, and metrics for climate-related disclosure. On 7 March 2019, the European Parliament and EU Member States agreed on new rules for disclosure requirements related to sustainable investments and sustainability risks. The new regulation sets out how financial market participants and financial advisors must integrate ESG risks and opportunities in their processes, as part of their duty to act in the best interest of clients. It also sets uniform rules on how those financial market participants should inform investors about their compliance with the integration of ESG risks and opportunities. Regarding the EU taxonomy, the TEG launched a call for feedback on EU action to develop the EU taxonomy which closed on 22 February 2019 and responses are now being assessed by the TEG.

Africa and Middle East

Several 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

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

presidency of the 22nd session of the Conference of Parties (COP 22). As a first step 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 (totaling 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).[13] 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 Capital Markets Authority (CMA) Kenya in collaboration with the Nairobi Securities Exchange, Climate Bonds Initiatives, Kenya Bankers Association, Financial Sector Deepening Africa, Dutch Development Bank FMO and IFC developed the Kenya Green Bonds Guidelines following which the regulatory framework for issuance and listing of green bonds was developed. The framework came into effect in January 2019 and provides for issuances compliant with the Green Bonds Principles, Climate Bonds Standard or such other standards that may be approved by the CMA. The framework further provides for eligibility criteria for independent reviewers and disclosure and continuing reporting obligations.

One of the key strategic focus of the CMA's Strategic Plan (2018-2023), is to ensure that capital market players enhance their policies around general corporate governance and environmental, social and governance (ESG) factors. The CMA and the International Finance Corporation, in February 2019 held sensitization workshops for Issuers of Securities to the Public on emerging ESG trends, challenges and opportunities. The CMA is also in the process of developing a survey to be rolled out end of May 2019 to issuers and institutional investors to explore the extent to which issuers of securities to the public and institutional investors in Kenya have the understanding, capacity and appetite for extending the range of ESG matters in their companies' strategies and disclosures and to inform the development of scorecards and reporting templates, in conjunction with the Nairobi Securities Exchange (NSE), to guide issuers of securities to the public and institutional investors as responsible stewards on ESG reporting. In the meantime, the Authority is considering an application for one green bond issue.

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[13] 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.[14]

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. In 2018, for example, more than 2,000 asset managers and pension funds, representing about US$80 trillion in assets under management,[15] had signed the UN-backed Principles for Responsible Investment (PRI). In addition, the Climate Bonds Initiative (CBI)[16] 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."*[17]

At the same time, the market for sustainable instruments, particularly green bonds, has developed steadily over the last five years. The 2018 Green Bonds Market Summary published by the CBI[18] states that 1543 green bonds were issued by 320 issuers in 2018, for a total of US$167.3 billion. Of this amount, US$40 billion were issued in emerging markets, which accounted for around 20% of total issuance. The same publication states that 2018 saw an

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

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

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

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

18 https://www.climatebonds.net/files/files/2018%20green%20bond%20market%20highlights.pdf

increase in issuance of sustainability, SDG and social bonds, thereby increasing the total labelled bond issuance to US$226.1 billion, or up 13%.

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) introduced the first version of their GRI Guidelines in 2000 and launched its Sustainability Reporting Standards (GRI Standards) in October 2016 which build on the learnings of the GRI Guidelines. 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.[19]

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[20] 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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19 http://www.sseinitiative.org/data/

20 http://www.sseinitiative.org/sse-partner-exchanges/

Chapter 5 – 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 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. The recommendations are intended to cover some of the critical aspects that can support the development of sustainable finance in GEM jurisdictions. As sustainable finance continues to evolve, these recommendations may need to be revised and adapted, as appropriate.

In issuing this set of recommendations, the GEMC believes they will help achieve a degree of international consistency and harmonization and thereby assist investors and issuers, given the cross-border and global nature of sustainable instruments. The recommendations take into consideration the IOSCO Principles and Methodology,[21] 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 recommendations related to sustainable instruments also take into consideration the main elements identified by a number of public and private sector groups. In applying these recommendations, regulators and market participants are encouraged to maintain an open dialogue, taking into account local conditions, the level of market development in their jurisdictions and global/ regional efforts in the area of sustainable finance. In line with IOSCO Principle 16 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. In addition, the recommendations also cover requirements for institutional investors and for building capacity and expertise for ESG issues.

The full list of recommendations is included in the Appendix to this report.

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

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

Recommendation 1 aims to promote the integration of ESG-specific issues into the overall risk assessment and governance of issuers and other regulated entities. Board commitment to reporting provides credibility for sustainability commitments and corporate performance. It indicates that ESG risks and opportunities that may impact corporate performance are considered alongside all value drivers in corporate strategy and management. It will also promote the development of sustainable investments and contribute to a more sustainable economy. ESG factors should therefore be integrated in the corporate strategy, risk management, operations and performance assessment of companies.

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 several 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[22] 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: Institutional investors. Consistent with their fiduciary duties, institutional investors, including asset managers and asset owners, are encouraged to 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 2 refers to institutional investors. An increasing number of jurisdictions are establishing stewardship codes to help foster investor engagement and promote shareholder activism on ESG-related matters. These institutional investors include not only asset managers, but asset owners like pension funds as well, whose time horizons are likely to be aligned towards longer-term investment. Further, as mentioned above, more than 2,000 institutional investors have signed the PRI and are committed to incorporating ESG-specific issues into their investment analysis and strategies. This Recommendation would further help the development of sustainable investments as institutional investors incorporate ESG-specific

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

issues into their investment analysis, strategies and overall governance, and take into account ESG disclosures of the entities in which they invest.

Recommendation 3: ESG-specific disclosures, reporting, and data quality. Regulators should require disclosure with regard to material ESG-specific risks (including transition risks) and opportunities in relation to governance, strategy and risk management[23] of an issuer. This information should be part of the overall disclosure that the issuer makes under Principle 16. Where regulators determine that ESG-specific reporting is needed, regulators and issuers 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., ESG rating providers, benchmarks and auditors.

Recommendation 3 refers to the ESG-specific disclosures and data quality for issuers. 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, 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. ESG-specific disclosure could include, for example, information on the issuer's analysis of ESG factors, the stakeholders involved in the process, and the link between ESG factors, corporate performance and the overall corporate strategy.

Data quality can be a key challenge in ESG-specific reporting. The use of external reviews (see recommendation 9 below) could increase the robustness and credibility of the ESG-specific reporting.

Recommendation 4: Definition of sustainable instruments. Sustainable instruments should be clearly defined and should refer to the categories of eligible projects and activities 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);

[23] 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).

- Social (human capital; product liability; and other social opportunities);
- Governance (corporate governance; corporate behavior).

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 of the 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 and eligible projects as provided in Recommendation 4 and 5.

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 (ETFs) 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. The ESG categories referred in these recommendations are sufficiently broad to take into account current and future developments in GEMC jurisdictions. As sustainable finance may evolve over time, the ESG categories could include new elements, as appropriate.

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 channeling more investments into sustainable instruments and contribute to the development of sustainable capital markets in many emerging markets. As highlighted above, various have issued voluntary standards relating to sustainable instruments. The European Commission is currently developing a taxonomy aimed to provide a unified classification system for sustainable economic activities in the EU. These existing globally recognized standards could be referenced when regulators develop regulations for sustainable instruments in their jurisdiction. In defining the list of eligible projects and activities for their jurisdictions, GEMC members are encouraged to keep an open dialogue with market participants and be informed by global and regional efforts to achieve the highest possible level of convergence or harmonization.

Recommendation 8 is directed to Market Authorities who are responsible for the supervision of the proper use of funds. For the purpose of this report, the term “Market Authority” would mean either the regulator, a Self-Regulatory Organization (SRO) or the authorized market. This broad definition is used in order to accommodate the varied supervisory practices in use by GEMC members. Accordingly, this recommendation does not prescribe what type of Market

Authority or combination of Authorities should be responsible for the regulation and supervision of the proper use of funds in a particular jurisdiction.

Recommendation 10: Building capacity and expertise for ESG issues. Regulators should analyze 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 10 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 the integration of ESG-specific issues 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 includes the integration of ESG issues in regulatory risk assessments and supervisory approaches. This Recommendation would also help market participants understand the importance of the integration of ESG-specific issues and develop the supply of the sustainable instruments and the demand from retail investors and institutional investors in emerging markets.

Appendix – List of Recommendations

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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.

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