Sustainable Finance

Overview of issues for the financial sector
International challenges & progress

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Robert D. Patalano*
Head of Financial Markets Division
OECD

*Contributions from Catriona Marshall, Riccardo Boffo, Giulio Mazzone, and the *OECD Committee on Financial Markets*.

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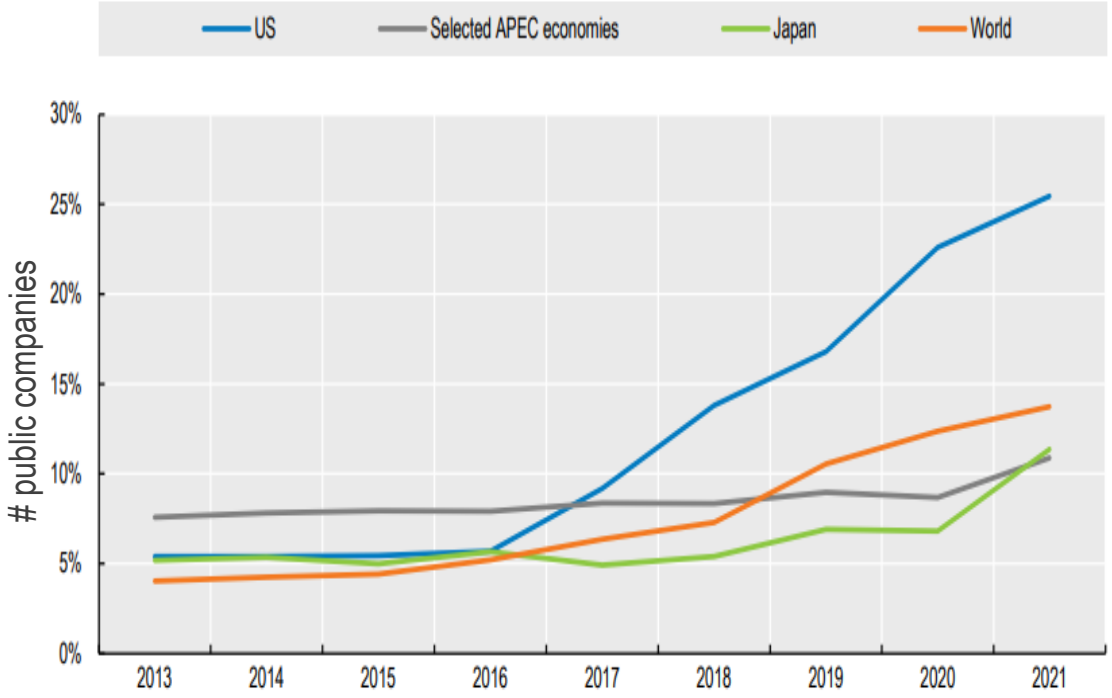
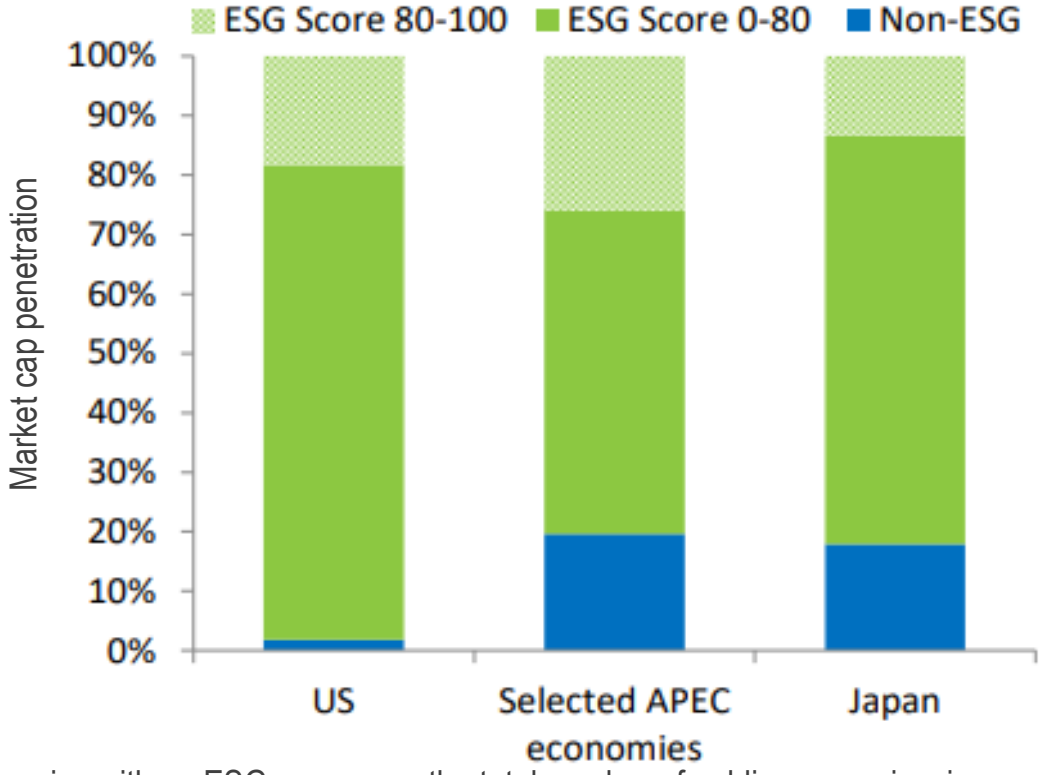
The rise of ESG forms of sustainable finance

- ESG ratings and investing are being mainstreamed across major markets, by number of companies and even more by market capitalisation. This suggests that the companies with large market capitalisation are much more likely to have ESG scores.

Growth of ESG ratings coverage, by company



Growth of ESG ratings coverage, by market cap

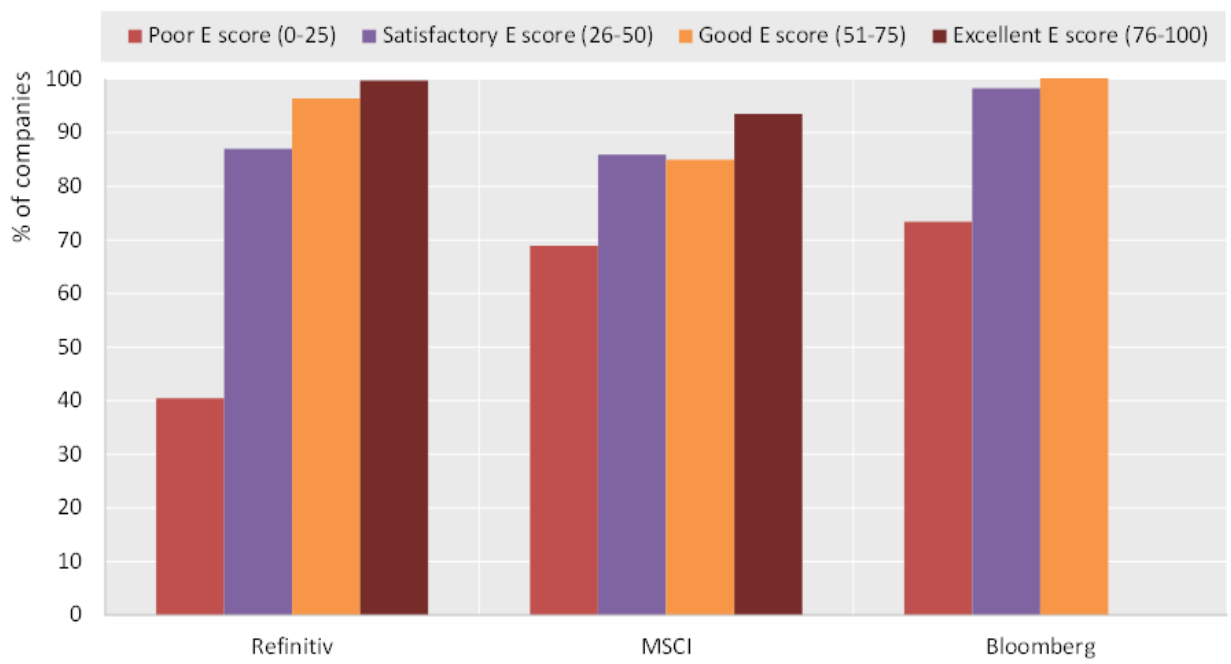


Source: Refinitiv, OECD calculations. (LHS) Calculated as the number of public companies with an ESG score over the total number of public companies, in each year. (RHS) Market capitalisation calculated as of 01/01/2021. The Selected APEC economies include: Australia, Indonesia, Malaysia, New Zealand, Singapore, Republic of Korea and Thailand.

Climate transition – growing use and mainstreaming

- Progress in widespread adoption of ESG investment approaches to embed sustainability in long-term value.
  - ESG used by asset managers with $**40+ trillion AUM**; stock exchanges calling for **recommending guidance on ESG disclosure;** >80% market cap w/ ESG score coverage in major markets.
- Rising use of climate transition reporting across industries to communicate awareness, strategy and targets.

Shares of companies disclosing policy to improve *emissions reduction*

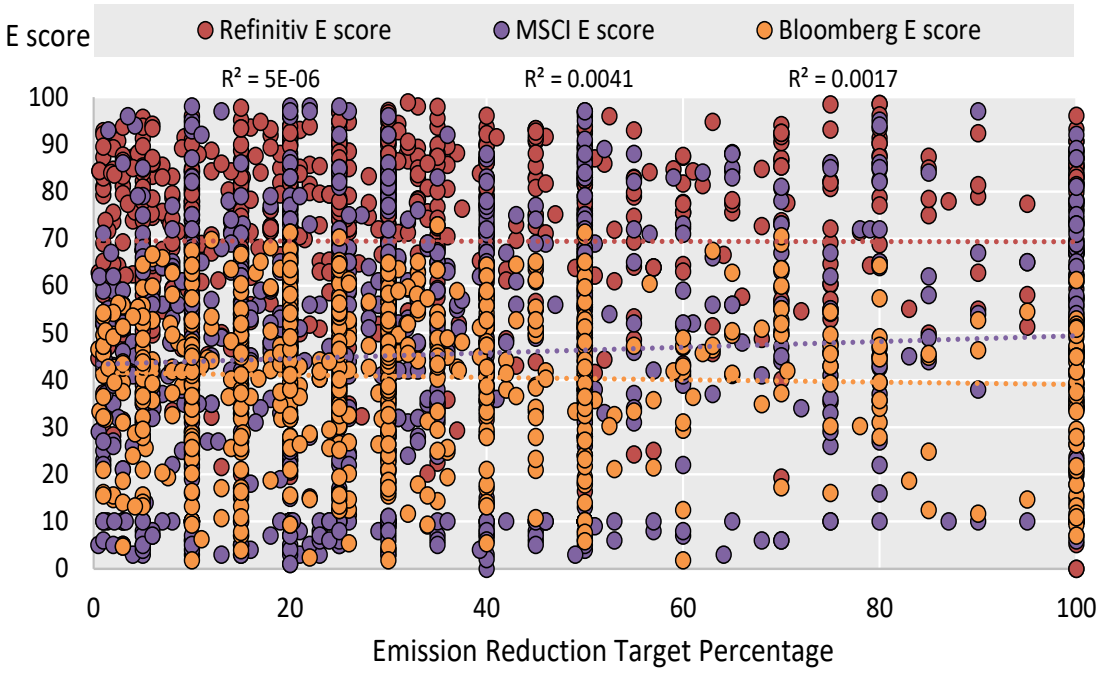


Share of companies disclosing targets or objectives on *energy efficiency*

Amid increasingly reporting emissions reduction targets, is reduction of carbon intensity rewarded?

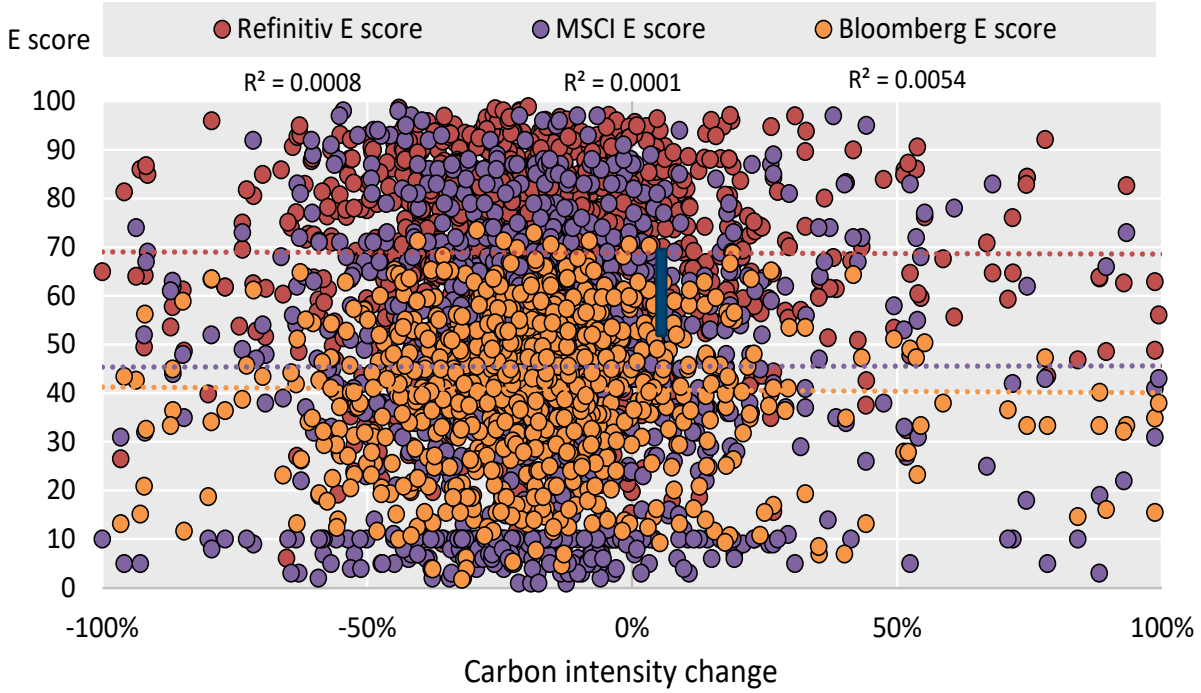
- The growing disclosure of emissions reduction targets, and the actual reduction of carbon intensity over the past 3 years, does not appear to affect the E pillar score of ESG.
- This raises questions as to the extent to which investors are willing to reward firms that are advancing against their targets.

Companies setting emission reduction targets do not consistently receive higher "E" pillar scores



Note: Percentage of emission reduction target set by the company as reported by Refinitiv.

The reduction of carbon intensity does not align with high "E" pillar scores

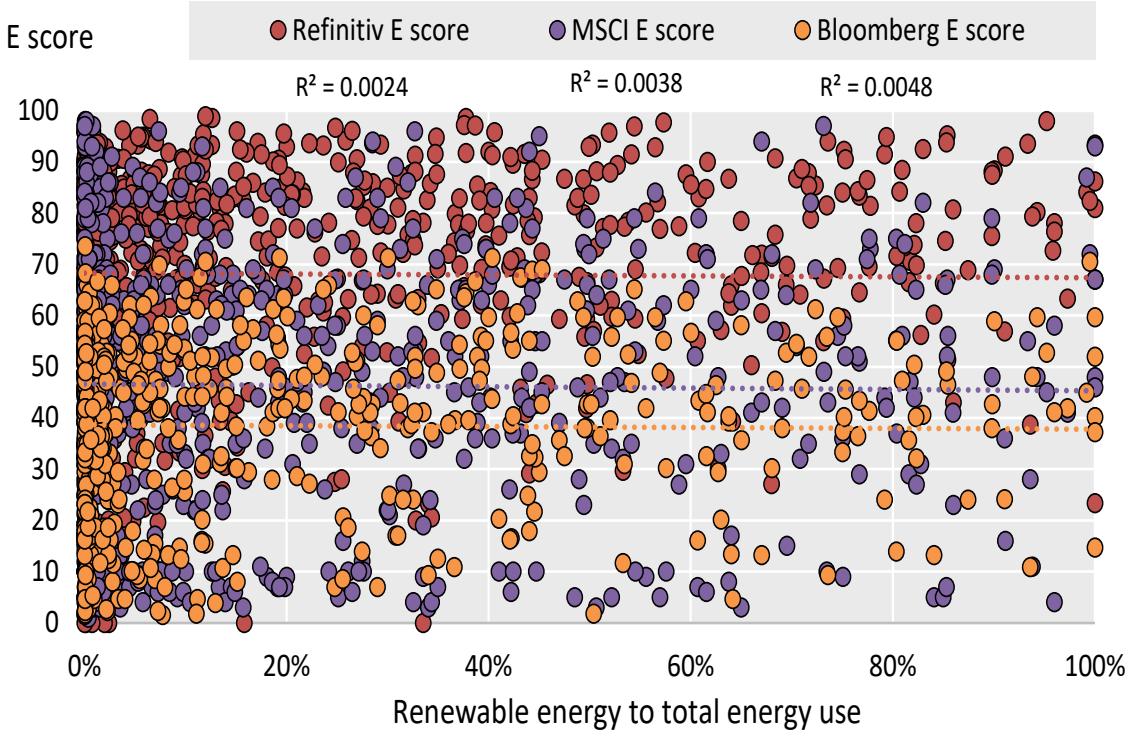


Note: Carbon intensity measured as total CO2 and CO2 equivalents emission in tonnes divided by net sales or revenue in US dollars in million.

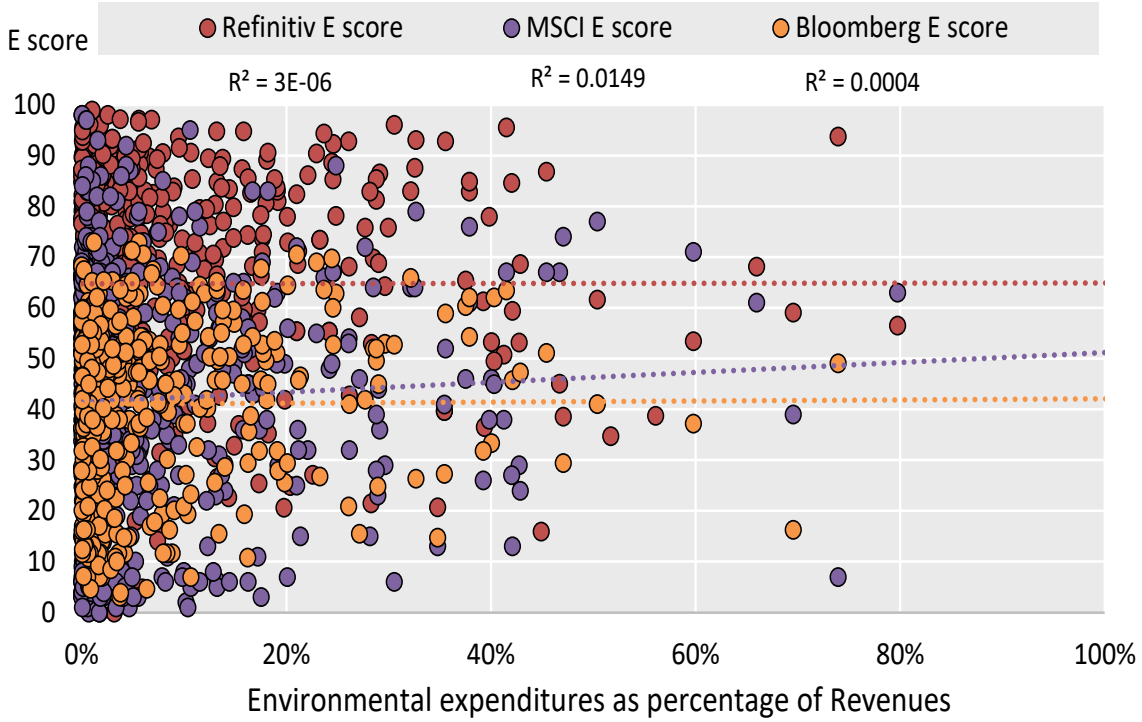
Should investors reward higher use of renewables or environmental expenditures?

- Companies' climate transition strategies include environmental expenditures, environmental R&D, and renewable energy use as % of total energy, which signals the strategy to transition.
- Yet, there is currently no material relationship between the E pillar score and either higher use of renewable energy or environmental expenditures (See low correlation on charts below).

Higher use of *renewable energy* (% of total energy used) does not imply higher "E" pillar scores



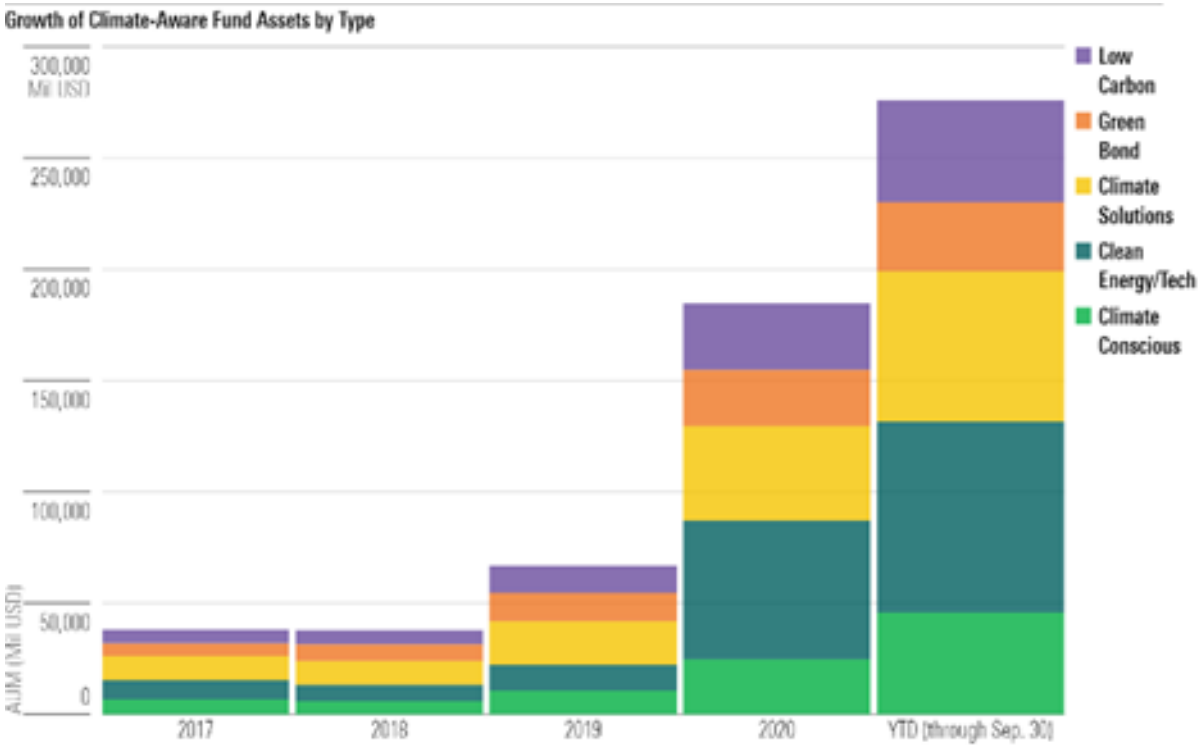
Higher *environmental expenditures* (% of revenues) do not align with higher "E" pillar scores



Carbon intensity of "climate aware" funds for retail investors vary greatly

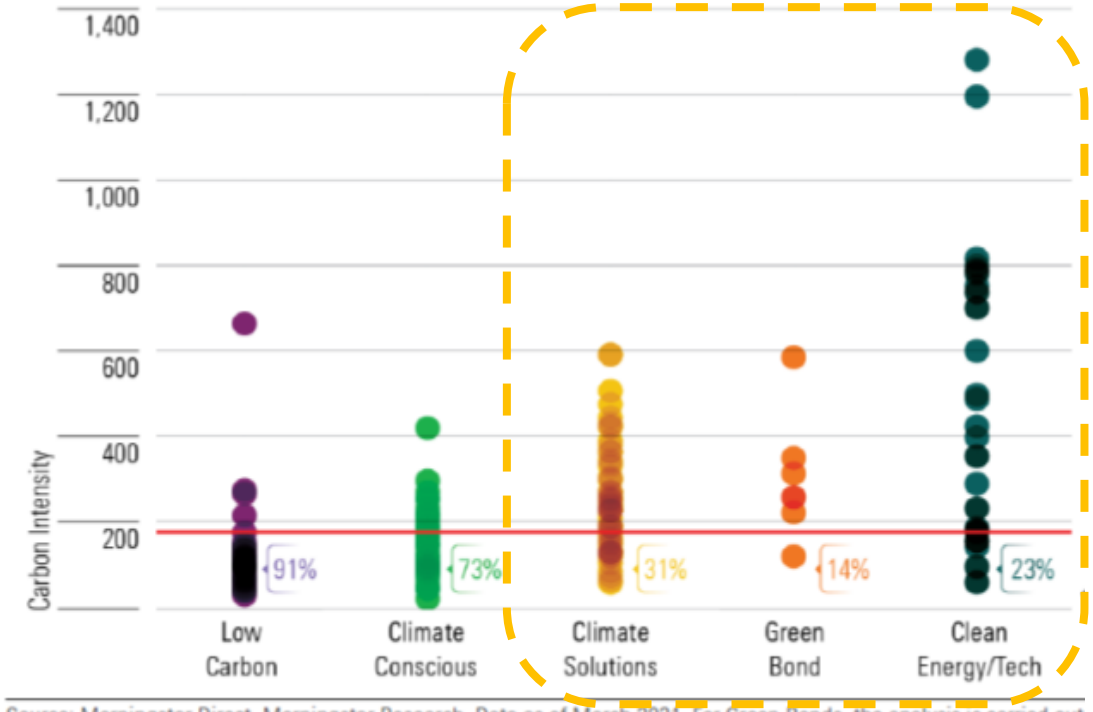
- Sharp growth of "climate aware" funds, which include a range of investment styles have risen x5 in several years.
- Yet, some investment styles – climate solutions, green bonds, and clean energy, have *much more carbon intensity* than typical funds.

Growth of "Climate Aware" Funds (assets by type)



Source: Morningstar Research, Morningstar Direct. Data as of September 30, 2021.

***Carbon Intensity* by Type of Climate Aware Funds**



Source: Morningstar Direct. Morningstar Research. Data as of March 2021. For Green Bonds, the analysis is carried out

% = percentage of funds by AUM that are below the Morningstar Global Target Market Exposure

2021 Initiatives set the pace for 2022 with OECD contributions

FSB FINANCIAL STABILITY BOARD →

- Report on Availability of Data to Assess Climate-Related Risks to Financial
- FSB Roadmap for Addressing Climate-related Financial Risks

NGFS Central Banks and Supervisors Network for Greening the Financial System →

- Central banks' ESG Integration; Climate scenarios; Climate disclosures; Bridging data gaps.

COP26 →

- **GFANZ** → coalition for $100+ trillion
- **IFRS** to create ISSB to develop global baseline reporting for sustainability (climate first)

G20 ITALIA 2021 → G20 INDONESIA 2022 →

- **Launch of G20 Sustainable Finance Roadmap**
- Developing a **high-level transition finance framework** for taxonomy, transition disclosure, and financing instruments.
- Improving the **transparency and accountability** of financial institutions' transition-related commitments.

The OECD builds momentum to improve ESG and climate transition practices

MEETING OF THE OECD COUNCIL AT MINISTERIAL LEVEL

October 2021

- Climate Finance sessions
- Ministerial statement

"We look forward to analysis of how ESG risk is addressed across OECD workstreams to foster integrated approaches to sustainable finance, including on principles for climate transition finance."

NEW ZEALAND APEC 2021

Summer, 2021

- Conference on ESG Investing and Quality Infrastructure

CENTRE ON GREEN FINANCE AND INVESTMENT

October 2021

- Sessions on ESG, Climate Transition, SDGs

G20 Roadmap Annex - Initiatives of OECD Directorate for Finance and Enterprise Affairs

Focus Area 1	Focus Area 2	Focus Area 3	Focus Area 4	Focus Area 5
Market development and approaches to align investments to sustainability goals	Consistent, comparable, and decision-useful information on sustainability risks, opportunities and impacts	Assessment and management of climate and sustainability risks	Role of IFIs, public finance and policy incentives	Cross-cutting issues

ESG to strengthen alignment with SDGs.

Develop a **dashboard of climate-related risks on financial markets.**

Contribute to **IFRS ISSB**

Updating **Corporate Governance Principles** to include ESG Risks.

Stocktaking of **OECD Guidelines for Multinational Enterprises**

Report on **Biodiversity Risks** in Financial Markets.

Development of indicators and **ESG materiality mapping**

Develop **ESG Risk Policy Framework**, to integrate its analysis, policy recommendations, and updating of legal frameworks.

Policy recommendations on **climate transition eligibility, high-level recommendations, and climate risk due diligence** of climate risks.

Policy Recommendations to improve ESG and climate transition practices

Market Practices for ESG Investing

- Strengthen ESG data, metrics, transparency of methodologies, and clarify purpose.

Market Practices for Climate Transition

- Strengthen climate transition-related data availability and use; science-based targets; verification and investor engagement strategies.

Good Practices for Central Banks & Financial Authorities

- Good practices in ESG integration, climate-related disclosure, and climate scenarios for stress testing.

➢ *Includes **high-level recommendations**, **sub-recommendations** to strengthen key practices, and emerging **good practices** by central banks, financial authorities, and market participants.*

Concept of OECD "ESG Risk Policy Framework"

ESG Risk Policy Framework

Analysis, policy considerations, legal instruments, and capacity building regarding ESG risks, ratings and investing, due diligence, governance, and alignment with climate transition.

Analysis

ESG Investing

E of ESG

Financial Markets & Climate Transition

Alignment of Metrics w/Climate Transition

ESG & SDGs

2020-2022

Policy considerations

Key ***Committee policy recommendations*** from the analytical findings.
→ *Climate transition definitions, transition recommendations, and due diligence.*

2021-2022

Legal Instruments

Update key legal instruments related to **governance, business conduct, and financial markets.**

2022-2023

Capacity Building

Engage to ***strengthen alignment with sustainability and orderly climate transition, environmental integrity in finance***.

2022 →