



INVESTMENT STRATEGY AND INVESTMENT HORIZON: OECD WORK ON ESG, THE INVESTMENT ECOSYSTEM AND GREEN FINANCE

ESMA Workshop on Short-Termism

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1. ESG AND THE INVESTMENT ECOSYSTEM

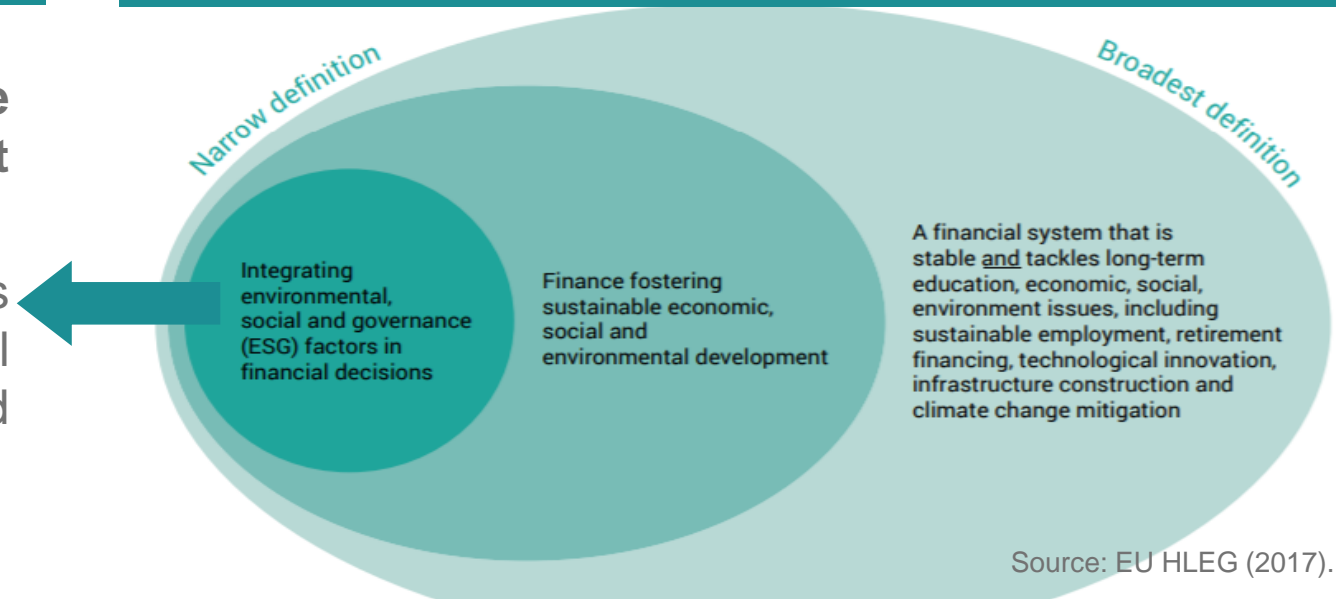


Environmental, Social and Governance (ESG) criteria and sustainable finance

What is ESG?

- A risk management approach to integrate long-term “sustainability” into investment decision-making.
- General alignment with societal values related to environment and corporate social responsibility, and principles of good governance.

Three definitions of sustainable finance



Environmental

- climate change – including physical risk and transition risk
- Biodiversity loss and other resource depletion (e.g. water)
- waste and pollution

Social

- working conditions, including slavery and child labour
- local communities (e.g. indigenous)
- conflict
- health and safety
- employee relations and diversity

Governance

- executive pay
- bribery and corruption
- political lobbying and donations
- board diversity and structure
- tax strategy

Source: Adapted from UN-PRI

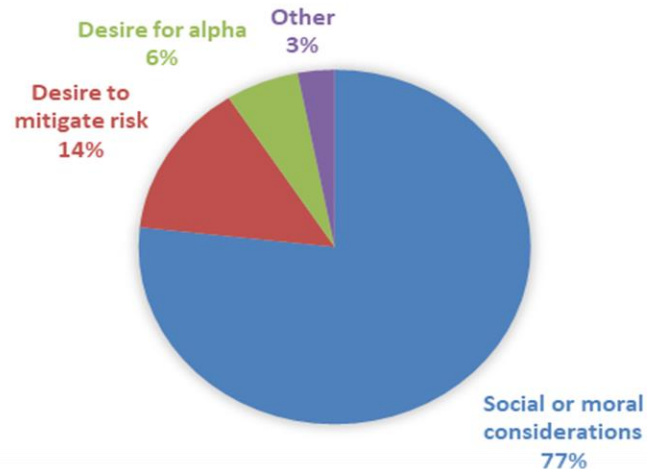


Why the attention to “ESG for sustainable” investment?

- Key driver is from Millennials that want financial returns that are aligned with societal goals.
- Rotation away from purely commercial investing has been due to investors’ desire to improve issuers’ alignment with “social or moral considerations.”
- While asset owners may appear to appreciate the environmental and societal elements of ESG investing, asset managers are more focused on governance.

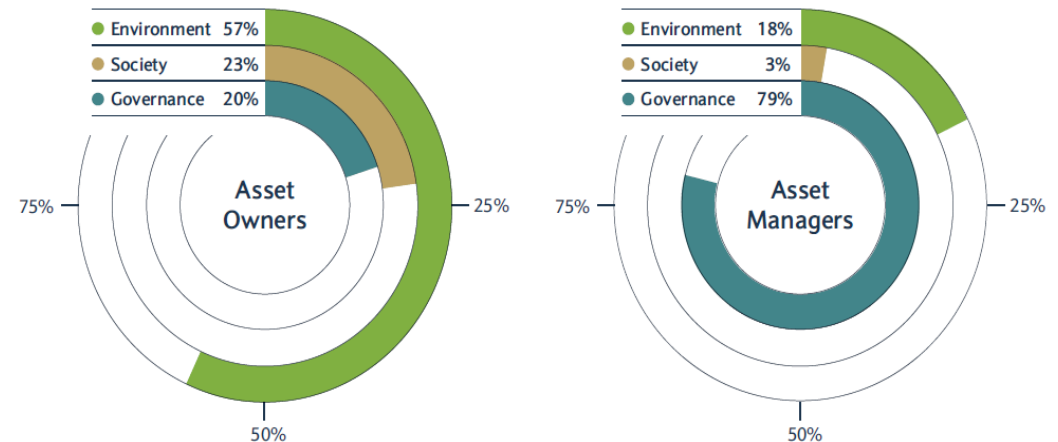
ESG adoption drivers

WHAT IS THE PRIMARY DRIVER OF CONSIDERING ESG IN YOUR OR YOUR CLIENTS' INVESTMENT DECISIONS?



Source: Bank of America Merrill Lynch (2018), “The ABCs of ESG.”

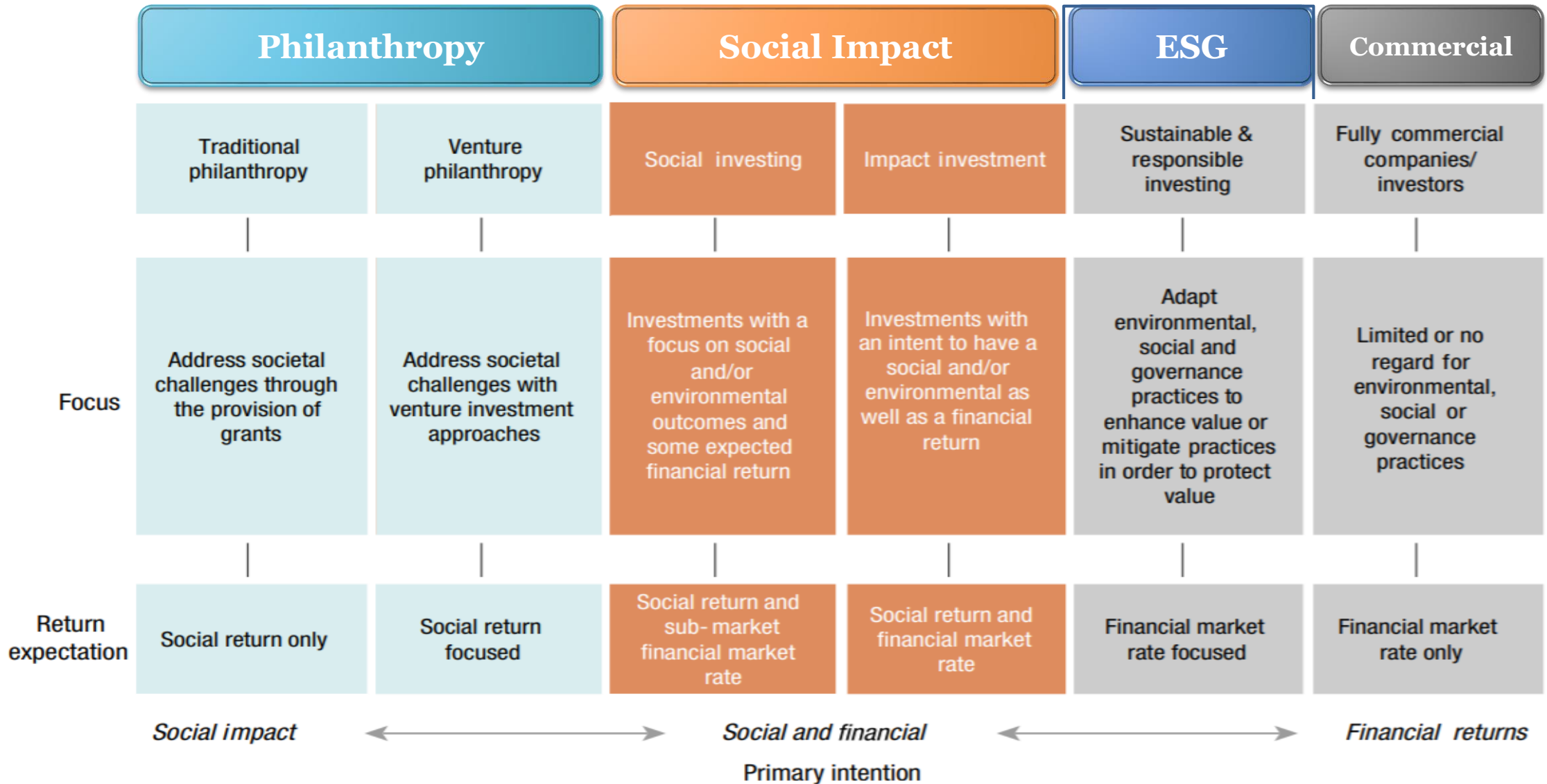
Survey – importance of ESG factors



Source: Barclays Research (2017)

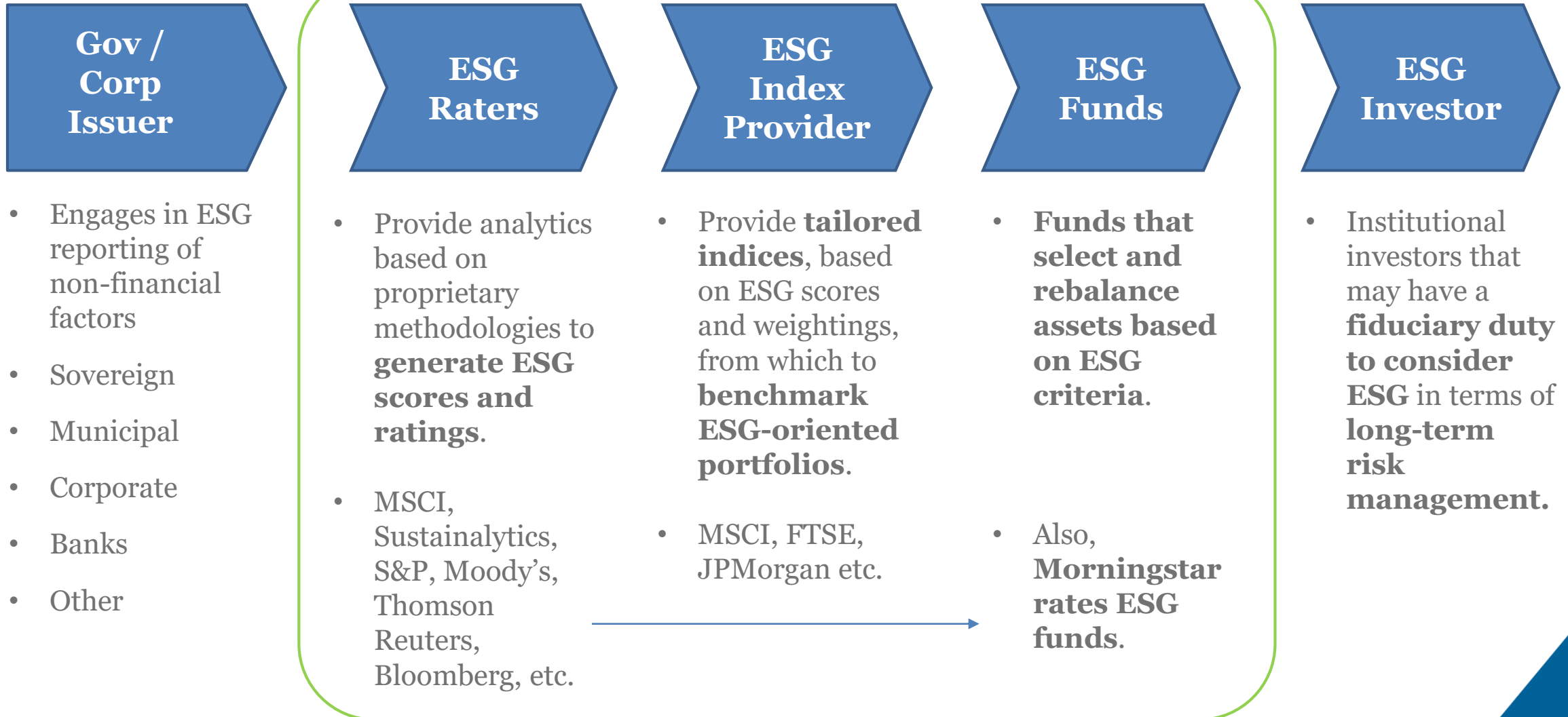


ESG within the investment spectrum





The ESG intermediation chain

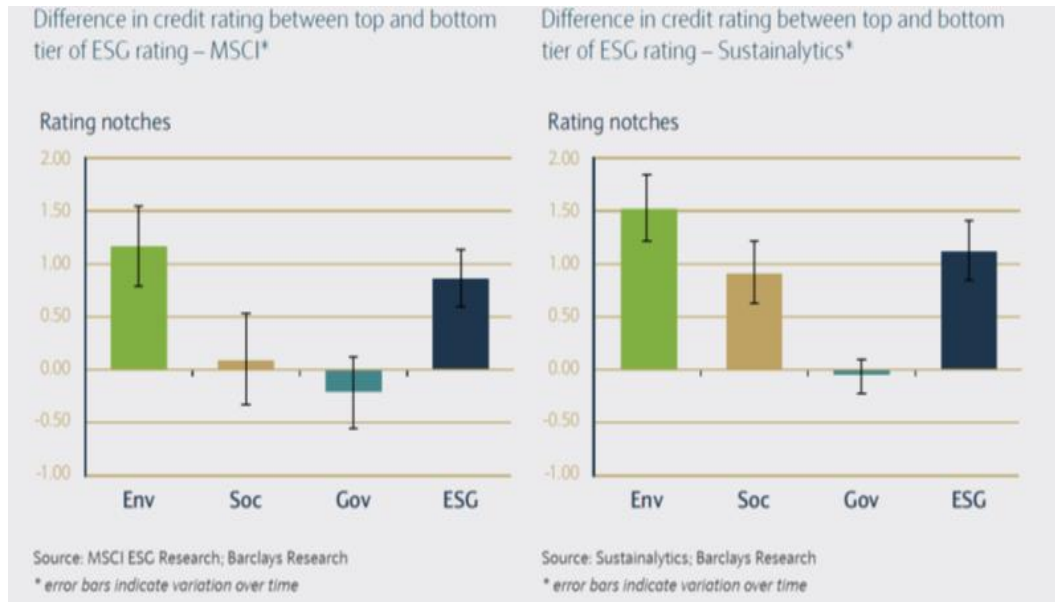




ESG ratings considerations

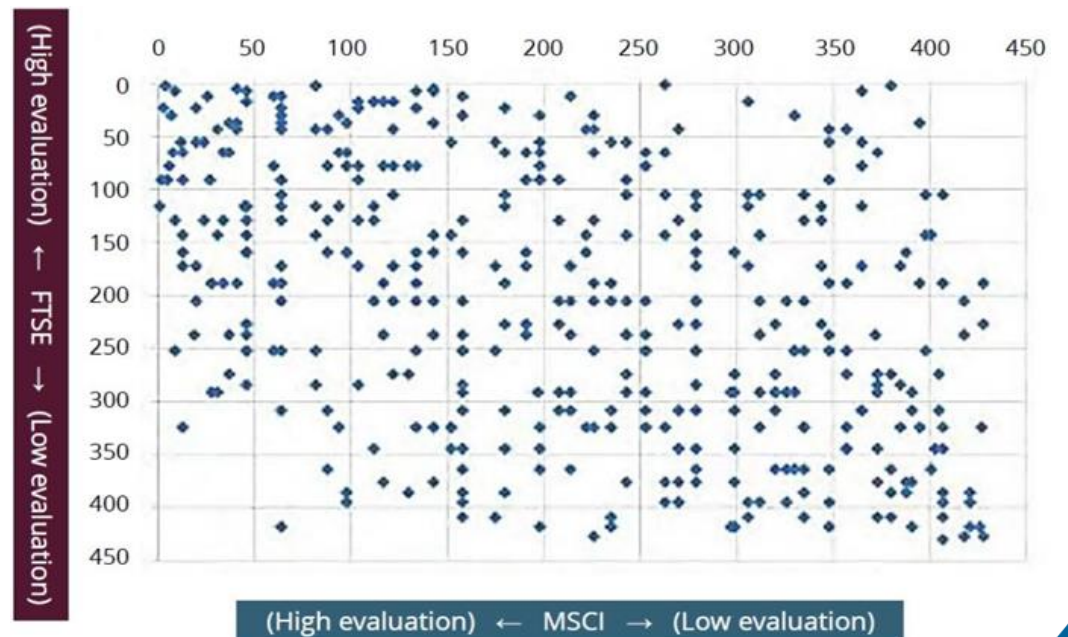
- Relationship between traditional credit ratings and components of ESG vary considerably within score factors and across rating firms.
- Some concerns that ratings vary considerably across ratings providers.
- Therefore, constituent weights in a high-ESG scoring index vary considerably across providers.

Comparison - credit ratings and ESG ratings



Source: Barclays Research (2017)

Comparison of ESG – FTSE vs MSCI scores



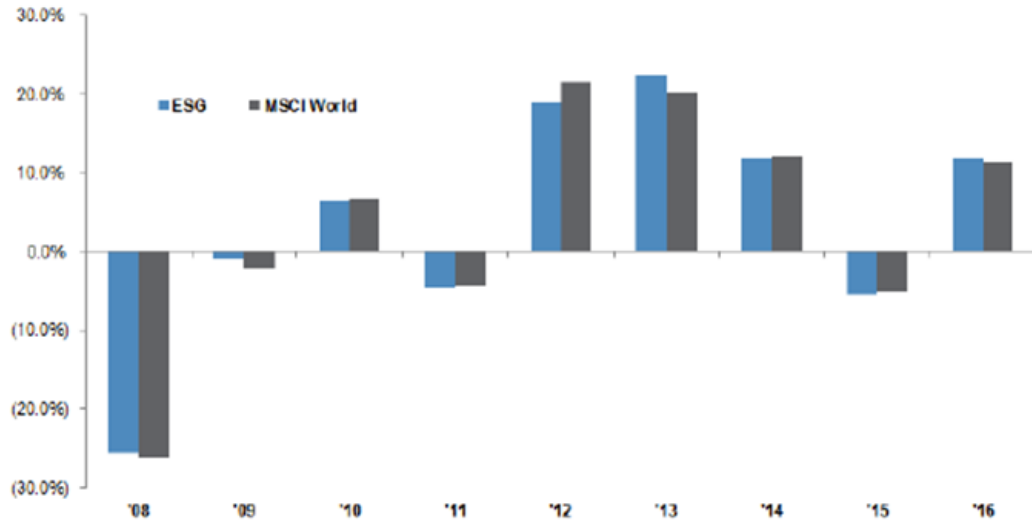
Source: CLSA, GPIF



Attributes of ESG performance

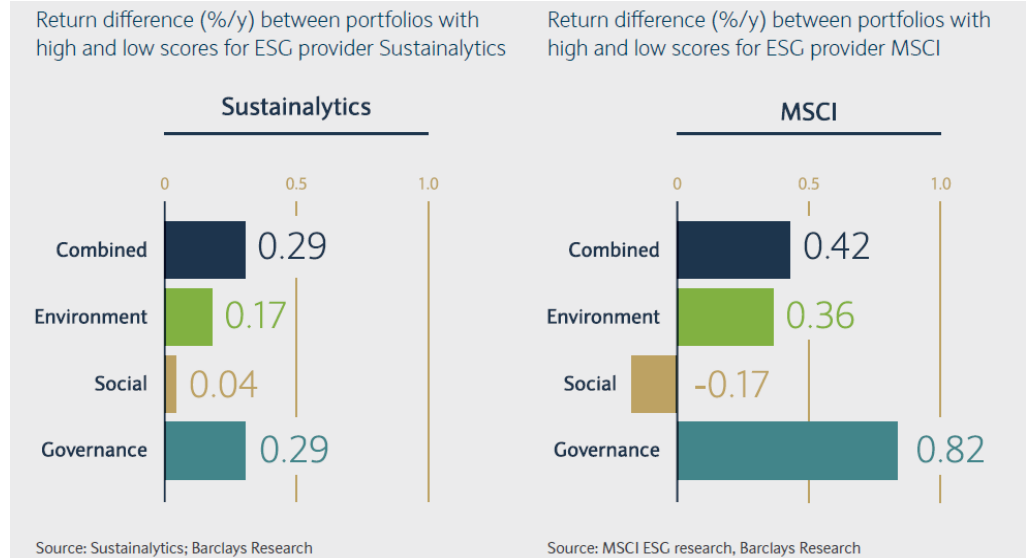
- Some research indicates that ESG-tilted portfolios can outperform traditional indices.
- However, studies are mixed as to whether there are biases associated with asset or market size, higher ROE, or even P/E expansion due to greater demand.
- There is some evidence that governance and environmental scores are contributing to or correlated with improved return differentials between high and low-scoring portfolios.

Performance - ESG vs traditional benchmarks



Source: JPMorgan (2016), ESG Investing

Performance - ESG factors



Source: Barclays Research



Issues for consideration

Taxonomy and classification

- Various terms are used in different ways across the industry → difficult to know what actions/decisions are associated with various terms, and implication for risks and returns.

Ratings and data comparability

- There is insufficient consensus on the appropriate metrics to be used for ESG for issuer disclosure and ratings assessment, and ratings approaches and scores vary widely.
- Also, lack of transparency over detailed methodologies and judgment results in different ESG ratings, which can in turn influence index weights and portfolio tilting based on ESG scores.

Performance & benchmarking

- Range of fund styles and index benchmarks makes it difficult to understand (a) performance on a relative basis, and (b) the extent to which goals other than financial risk-adjusted returns are pursued by the funds.

Promising developments → but need for policy engagement to ensure transparency, comparability, and integrity.



Selected OECD work on ESG

OECD Directorate for Financial and Enterprise Affairs is engaged in ESG assessment, stakeholder outreach and policy guidance.

Financial markets

- Committee on Financial Markets has held a financial roundtable on ESG investing and funds, and has assessed trends and issues (forming the basis of this presentation).
- Secretariat will conduct quantitative analysis of ESG ratings, investment, performance and fund labelling, and will present findings to the Committee in October 2019.

Institutional investors

- Paper published -- OECD (2017), “Investment governance and the integration of environmental, social and governance factors.”
- IOPS (International Org. of Pensions Supervisors) completed consultation of “Supervisory guidelines on the integration of ESG factors in the investment and risk management of pension funds.”

Other

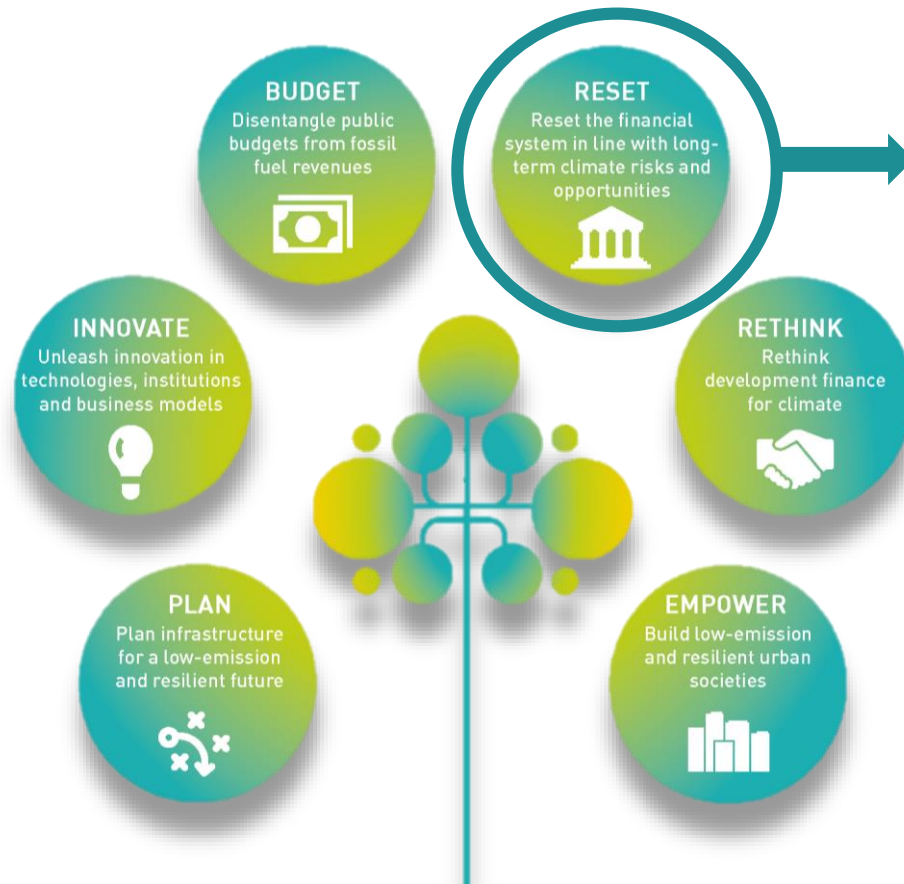
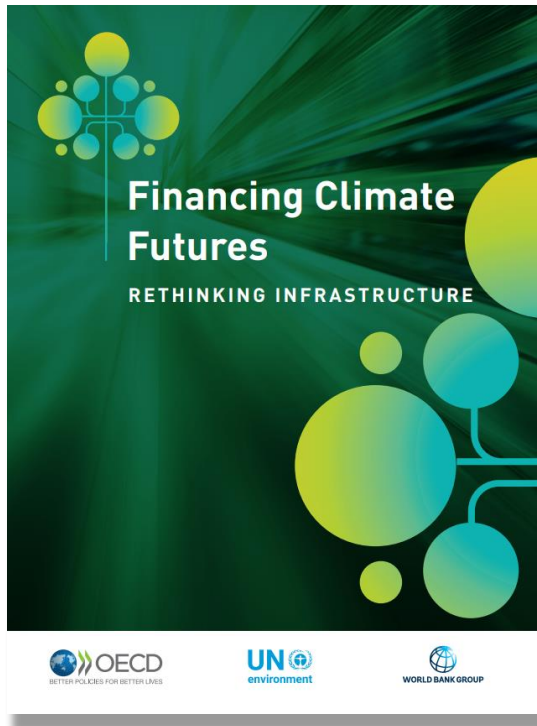
- Future consideration of ESG within sustainable infrastructure investment
- Initiatives through the OECD Centre on Green Finance and Investment
 - Annual Forum on Green Finance and Investment
 - OECD (2018), “Integrating Climate Change-related Factors in Institutional Investment.”



2. OECD WORK ON GREEN FINANCE AND INVESTMENT



6 transformative areas to align financial flows with a low-carbon future, including to reset the financial system and address short-termism



Obstacles embedded in financial systems and regulations are hindering finance reallocation to long-term low-emission infrastructure investments:

- Definitions, information, data and capacities gaps
- Governance issues, including financial incentives across the financial system that favour short-termism



Sustainable finance taxonomies: potential to scale up sustainable finance

Why are Sustainable Finance Taxonomies a topic of interest?

- They may help **create green finance markets** by providing clear definitions that reduce fears of green washing.
- They may enable commercial banks to **better identify sustainable finance projects**, and therefore to finance them faster.
- They may **help attract savings and investment** to sustainable finance markets and projects.
- There is some degree of convergence between various taxonomies, and taxonomies may also **facilitate cross border investment**.

OECD work on sustainable finance taxonomies

- Work on **methodologies for tracking green finance**
- A **forthcoming report** on existing sustainable finance taxonomies early 2020
- The **Centre of Green Finance and Investment** is a platform to exchange on sustainable finance taxonomies and will hold an event in March on that topic.



OECD Forum on Green Finance and Investment



- **6th Forum, 29-30 October, 2019, Paris** <http://www.oecd.org/cgfi/forum/>
- Annual flagship event of the OECD Centre on Green Finance and Investment
- Gathers senior policy makers and key actors in green finance and investment from around the world
- 5th Forum on 13-14 November 2018, Paris:
 - **600** delegates
 - **62** high-level speakers
 - **69** countries represented: **25** OECD & **44** non-OECD member countries
 - **600** connections on the live webcast
 - **61 701** twitter impressions



THANK YOU