GET²
Global ESG Think-Tank
Finance and Law Engaging our Society

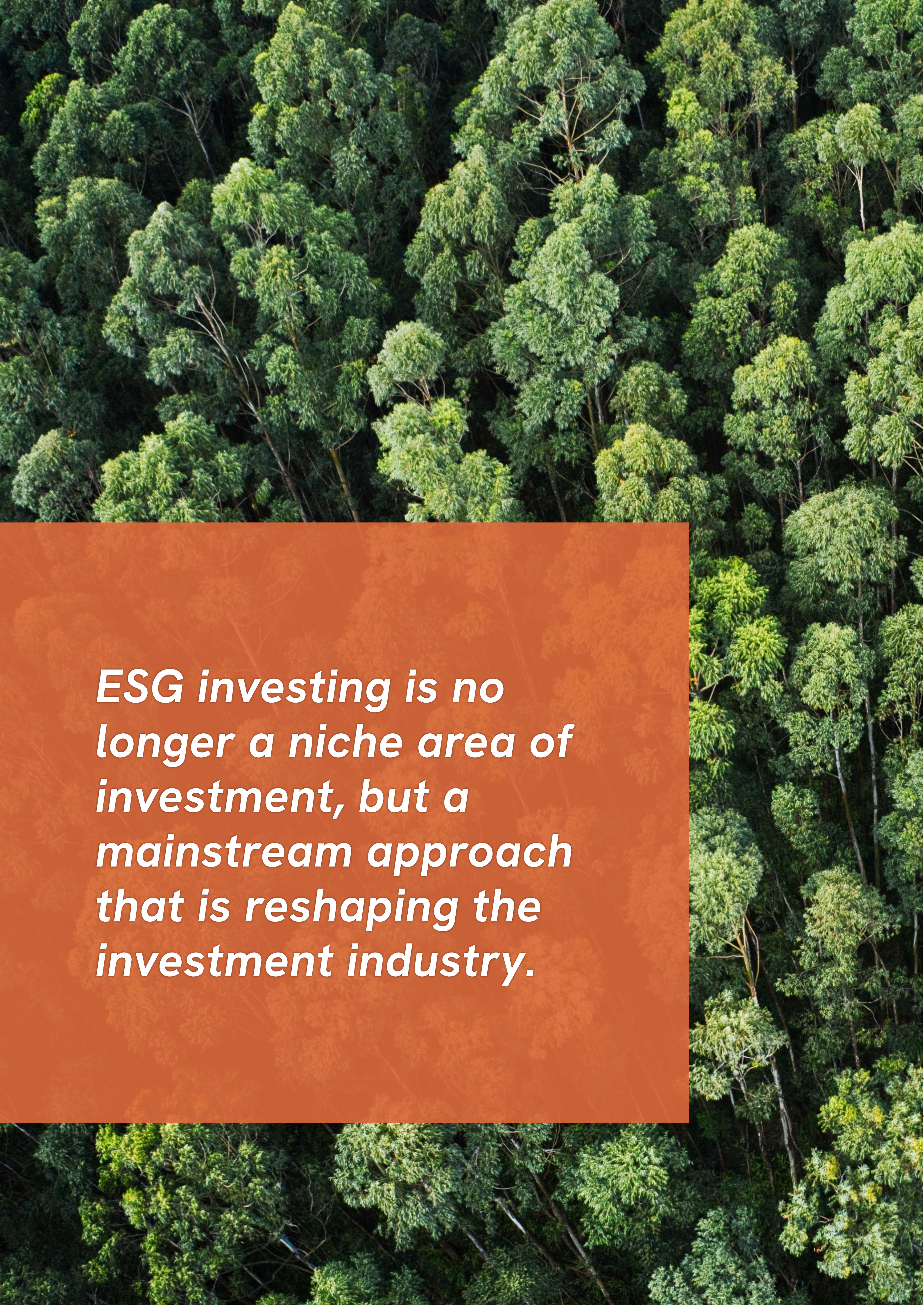
Oxford/23 Congress

OVERCOMING THE MAIN ESG INVESTING CHALLENGES

An initiative by Fide's GET-2 ESG Think-Tank

FINAL REPORT

Fide · Columbia Threadneedle Investments · Pictet Asset Management · GAM Investments · M&G Investments · Instituto BME X · fiap



ESG investing is no longer a niche area of investment, but a mainstream approach that is reshaping the investment industry.

Introduction

OVERCOMING THE MAIN ESG INVESTING CHALLENGES

Over the last decade, Sustainability and Net Zero Transition have become an unavoidable topic among participants in the investment industry. For asset managers, especially in Europe, ESG regulation has forced them to rethink the strategic pillars of the business not only in terms of investments, but also regarding its structure, governance, product development practice, relationships with clients and data providers, employees and supervisory bodies, regulators, and distributors... We can no longer talk about ESG as a side business or as a chosen path. Sustainable Investing is leading the investment industry revolution towards a new and more sustainable way to do business.

More than 30 taxonomies, asset classes ignored, questionable metrics and lack of significant amount of data brings challenges to investors. They are also struggling to quantify the cost of climate change transition and trying to cope tons of new acronymous. There is a need of pragmatism, it’s time to mitigate negative side effects of a necessary transformation and to re-join forces to make sustainable the will to investing in sustainability. End clients are dealing with an alphabet soup, and we need to remember that investment preferences are not constant, nor linear neither driven by high conviction. We need to find sensible solutions to balance urgent long-term goals with short term pragmatic implementation and actual motivations.

Of course, as it often happens when revolutions set place, the change of the former paradigm makes most of the actors quite uncomfortable, as they are forced to step out of their comfort zone and join a deeply transformative stream for which they are not sufficiently trained. Over the few years since the actual regulation framework has taken off, we have been able to witness how disruptive the progression of the ESG transformation within the industry has been. In our view, there are several outstanding challenges that must be addressed to continue effectively and efficiently building a global ESG standardized pattern for clients, investment professionals, distributors and authorities, and of course corporates and companies involved.

GET2 has put together several international investment professionals from different practices within the industry (asset managers, asset owners, authorities, consultants...) aimed to point out what the main Sustainable investing challenges are right now and analyze the most efficient ways to overcome them. We have come to some practical conclusions, outlined in this paper, that intend to open a fair discussion on how to take steps further on the ESG global standardization and help the investment community, especially clients and investors, to better understand the implications of the ESG integration in their investing decisions.

There is of course no single recipes for this difficult task as Sustainability is a living body, always evolving and bringing new challenges to the playing field, but we feel that there is the need to publicly join forces to address these challenges and start building up on overcoming them. Through weeks of inspiring work, five groups have been studying five different challenges in the ESG investment world. Different voices, different points of view and dedicated group leaders have been responsible to synthesize on this paper some enlightening thoughts and bold proposals for a better understanding of the ESG revolution and some guidelines for the future of the sustainable investing industry.

Learn about the challenges analysed by the GET-2 Working Groups

Challenge 1: Fragmentation across global ESG taxonomy by regions and institutions. Develop strategies to harmonize ESG standards across geographical boundaries and financial institutions, fostering a unified and consistent approach.

Challenge 2: ESG key metrics and Ratings. Explore innovative methodologies for measuring and assessing ESG performance, providing financial stakeholders with reliable and transparent metrics.

Challenge 3: To quantify the cost of transition from fossil fuels to a clean energy economy. Does it make sense scenarios to define ESG Targets? Analyze the economic implications of transitioning from fossil fuels to renewable energy sources, determining the feasibility and potential benefits of setting ESG targets.

Challenge 4: ESG elephants in the room: Indicators for Sovereigns & Social Bonds. Identify essential ESG indicators for sovereign entities and social bonds, ensuring comprehensive evaluations and informed decision-making in these critical areas.

Challenge 5: New trends in ESG regulations. enhancements required. Examine emerging trends in ESG regulations, pinpointing areas that require enhancements to facilitate more effective and impactful policies.

Challenge 6: Challenges for ESG commitment across End-Investors. Address the challenges faced by end-investors in integrating ESG considerations into their investment strategies, fostering increased commitment to sustainable practices.

Challenge 7: Best practices to avoid Greenwashing. Highlight best practices and robust frameworks to combat greenwashing, promoting transparency and credibility in ESG reporting and communication.

Executive Summary - Working Groups

KEY FINDINGS

This comprehensive report delves into the intricacies of Environmental, Social, and Governance (ESG) investing, shedding light on the challenges and opportunities within the investment landscape. The following key findings encapsulate the essence of the report:

1. **Impact of ESG Regulation on Asset Managers**: ESG regulations have necessitated a profound revaluation of the fundamental pillars of asset management. This encompasses investments, organizational structure, governance, product development, and relationships with clients, providers, employees, and regulators.
2. **Transformation in Relationships**: ESG investing has significantly transformed the relationships between investment firms and their clients, providers, and regulators, reflecting a paradigm shift in the industry's dynamics.
3. **Challenges in the ESG Transition**: The shift towards a new ESG paradigm has introduced substantial challenges, including global fragmentation in ESG taxonomy, the demand for reliable metrics, and the integration of ESG factors into investment decision-making.
4. **Energy Transition Challenges**: The transition from fossil fuels to a clean energy economy emerges as a pivotal challenge, requiring a holistic approach to ESG investing that carefully considers the risks and opportunities inherent in the energy transition.
5. **Simplification of ESG End-Investor Profiling**: There is a growing demand from distributors to simplify sustainable end-investor profiling. The report underscores the necessity for a standardized framework for ESG disclosure and reporting, ensuring consistency across diverse regions and industries.

WORKING GROUP SPECIFIC FINDINGS

The report is enriched with insights from five specialized working groups, each focused on a distinct facet of ESG investing. Here are the key findings from each working group:

WG 1: Fragmentation across Global ESG Taxonomy

- The lack of a unified approach to ESG investing across regions and institutions poses a significant challenge.
- Recommendations include strategies to harmonize ESG standards globally.

WG 2: ESG Key Metrics and Ratings

- Measuring ESG performance requires the usage of adequate and reliable data in line with the investment philosophy and the use case.
- Recommendations advocate for standardised metrics and improved transparency on ratings.

WG 3: Quantifying the Cost of Transition to a Clean Energy Economy

- Focuses on quantifying the cost of transitioning from fossil fuels to a clean energy economy, considering indicators like inflation, GDP, and market performance expectations.
- Recommendations suggest establishing a standardized framework for evaluating transition costs and integrating these metrics into investment risk assessments.

WG 4: Indicators for Sovereigns in Emerging Markets & Social Bonds

- Concentrates on defining indicators for sovereigns in emerging markets and enhancing the understanding of social bonds' impact.
- Recommendations include developing specific indicators tailored for sovereigns in emerging markets and refining social bond frameworks to better measure and communicate impact.

WG 5: Challenges for ESG Commitment Across End-Investors

- The challenge focuses on fostering ESG commitment among end-investors.
- Recommendations propose a comprehensive approach to ESG investing, considering the challenges and opportunities in encouraging ESG commitment across end-investors.

GENERAL CONCLUSIONS:

In conclusion, the report underscores the evolving landscape of ESG investing. Key takeaways include:

1. ESG Investing's Mainstream Status: ESG investing has transcended its niche status, becoming a mainstream approach that reshapes the investment industry.
2. Challenges and Opportunities: While the transition to the new ESG paradigm poses challenges, it simultaneously offers opportunities for innovation and growth within the investment sector.
3. Need for Standardization: The industry must collaboratively develop standardized frameworks for ESG disclosure and reporting, ensuring consistency globally.

4. Industry's Role in Fostering ESG Commitment: Recognizing the challenge of promoting ESG commitment among end-investors, the report emphasizes the need for a comprehensive approach to ESG investing, considering the challenges and opportunities in encouraging ESG commitment across end-investors.
5. Continued Innovation: To navigate ESG challenges, the investment industry must continue to innovate, adapt, and collaborate.

RECOMMENDATIONS:

The report extends actionable recommendations for the investment industry to navigate ESG challenges:

1. **Develop a Standardized Framework**: Create a unified framework for ESG disclosure and reporting to enhance consistency across regions and industries.
2. **ESG Integration in Decision-Making**: Integrate ESG factors into investment decision-making and risk management processes, considering the unique characteristics of different asset classes and investment strategies.
3. **Enhance Transparency**: Promote transparency and accountability in ESG investing by providing reliable ESG metrics and ratings.
4. **Encourage Collaboration**: Foster collaboration and knowledge-sharing across the investment industry to promote innovation and best practices in ESG investing.
5. **Support for Clean Energy Transition**: Support the transition to a clean energy economy by investing in renewable energy and other sustainable technologies and establishing a standardized framework for evaluating the cost of transitioning to a clean energy economy.
6. **Comprehensive Approach to ESG Commitment**: Tailor ESG strategies to effectively encourage commitment among end-investors, acknowledging the diverse challenges and motivations influencing their ESG engagement.
7. **Enhancing Impact Measurement for Sovereigns and Social Bonds**: Develop specific indicators tailored for sovereigns in emerging markets and refine social bond frameworks to better measure and communicate impact.

By adopting these recommendations, the investment industry can contribute significantly to creating a more sustainable and transparent future. This report serves as a compass, guiding the industry towards impactful ESG investing and global sustainability, with a specific emphasis on fostering ESG commitment among end-investors.

EXECUTIVE SUMMARY - STANDALONE PAPERS:

KEY FINDINGS AND BRIEF CONCLUSIONS:

Paper 1 - Digital Technologies in the Green Transition and Growth:

Key Findings:

- Digital technologies are crucial for the green transition.
- Financing the green transition is estimated at $9.2 trillion annually, posing a significant challenge.
- Banks play a vital role, but their profitability and competitiveness must be maintained for effective financing.
- Solutions include capital release mechanisms and measures to enhance bank competitiveness.
- Simultaneous pursuit of digital and green transitions is essential for global growth.

Brief Conclusions: The paper underscores the importance of digital technologies in the green transition, acknowledging challenges in financing. It emphasizes the need for strategic solutions to maintain bank competitiveness and highlights the essentiality of parallel digital and green transitions for sustained global growth.

Paper 2 - Europe and LATAM: Current Situation of ESG from a Regulatory Viewpoint:

Key Findings:

- The paper provides a comprehensive overview of ESG regulations in both Europe and Latin America.
- Chile's initiatives, including the Public-Private Roundtable on Green Finance, showcase a collaborative effort.
- EU's sustainable finance strategy focuses on taxonomy, disclosure, and the European Green Bond Standard.
- IOSCO and ESMA contribute significantly to global regulatory reform, transparency, and tackling greenwashing.
- CNMV in Spain concentrates on revitalizing capital markets for sustainable finance.

Brief Conclusions: The paper concludes that Europe and Latin America are actively progressing in ESG regulations. It highlights collaborative efforts in Chile, the EU's strategic focus, and the significant contributions of international bodies like IOSCO and ESMA. The CNMV's efforts in Spain indicate a commitment to sustainable finance.

Final Report
Overcoming the main ESG investing challenges

Paper 3 - Situation of ESG in LATAM to be Discussed by Asset Managers and Industry Players:

Key Findings:

- Institutional investors in Latin America are embracing ESG considerations for long-term sustainability.
- The incorporation of ESG criteria in the investment decisions of asset managers allows them to better manage savings and contribute to the development of more sustainable economies.
- Trends include private pension funds embracing ESG and Latin American countries adopting ESG levers.
- Challenges include the need for standardized ESG information, alignment of investor criteria, and capacity-building.
- Advanced ESG integration is observed in countries like Brazil, Chile, Mexico, Colombia, and Peru.

Brief Conclusions: The paper concludes that Latin America is undergoing a transformative shift towards sustainable finance. It emphasizes the profitability of ESG investments, outlines key trends, and acknowledges challenges. Advanced ESG integration in specific countries highlights progress and sets the stage for continued collaboration and development.


The transition to a new ESG paradigm has created significant challenges for actors in the investment industry, but also presents opportunities for innovation and growth.

Contents

The investment industry needs to work together to develop a standardized framework for ESG disclosure and reporting that is consistent across different regions and industries.

GET²
Global ESG Think-Tank
Finance and Law Engaging our Society

FINAL REPORT

Oxford/23: Overcoming the main ESG investing challenges

Fragmentation across global ESG taxonomy by regions and institutions. New trends in ESG regulations required

Working Group 1 Report

WG 1 Report:

Fragmentation across global ESG taxonomy by regions and institutions. New trends in ESG regulations required.

ABSTRACT

ESG is a tide that washes over everything and everyone. It has become a central piece of business strategy that requires significant commitment from the board with a view to guarantee alignment with the strategy, values, and long-term business plan. In a fluid regulatory environment, companies need to ensure they are prepared to address complex and, in some cases, conflicting sets of legal and disclosure requirements, and identify areas of ESG risk, mitigation and best practice areas. Sustainable finance taxonomies are classification tools that help investors and other stakeholders to make informed decisions on sustainable investments and a centrepiece of ESG regulatory frameworks. There are concerns however that the proliferation of taxonomies and other asset alignment tools around the world with different methodologies can have negative effects including market fragmentation and increased compliance costs.

This paper contributes to the discussion identifying the main challenges as well as the main trends that will mark the ESG regulatory agenda in the coming years. The paper also provides a view of the main drivers and drawbacks of the current fragmentation of taxonomies as well as potential remedies.

Keywords: *Sustainability, ESG, sustainable finance, taxonomies, regulation, disclosure standards, methodologies, ESG ratings, transparency, comparability, engagement, greenwashing, greenhushing, greenbleaching, financial education*

REPORT

In recent years there has been significant progress in addressing ESG risks and opportunities in both visibility and urgency thanks to a strong political and regulatory momentum, a growing demand from investors, as well as the increasing interest of corporations in integrating ESG factors into their strategies, aware that this will position them favourably with investors and the public. **However, in the aftermath of the energy crisis and inflationary tensions, movements arise that question the reasonableness of ESG objectives**, the speed of their implementation and the cost/benefit of their application.

The European Union is a pioneer in political and regulatory momentum on sustainability, but we live in a globalized world, so to be competitive it is necessary to align regulations with **international standards**. Those standards, **currently under development should provide clear guidance to market participants and spur cross border investments.** In the meantime, different countries have been following different approaches to foster sustainable finance. **Moving forward we will require calibrated approaches that balance competing priorities and are aligned with long-term sustainability and profitability.**

The rapid evolution and complexity of the EU legislative framework on sustainable finance has led to uneven coverage of the various links in the sustainable investment value chain and inconsistencies between different pieces of legislation, which is hampering instruments such as benchmarks to be developed and used effectively. Among the most relevant inconsistencies, the concept of "do not cause significant harm to other ESG objectives" (DNSH) included in the BMR Regulation, on the one hand, and the Taxonomy and Disclosure Regulations (SFDR) on the other, stands out. The differences between investments and sustainable activities in SFDR and in the Taxonomy Regulation and the absence of this concept in BMR as well as the use of estimates and/or equivalent information in ESG metrics and the different definition of metrics to measure the same concepts are other examples. Given lack of definition of green bond in the EU, bonds have been issued following voluntary standards such as the widely used ICMA Green Bond Principles. The Green Bond Principles have encouraged issuers to disclose EU Taxonomy alignment of their projects since June 2021. However, a recent report found that only 22% of the corporate green bond market is aligned with the EU Taxonomy (based on an assessment of 17,000 green bonds), primarily those financing renewable energy projects. The new European Green Bond Standard (EU GBS), requiring the proceeds to be allocated to economic activities that meet the EU Taxonomy requirements would help ensuring the same standards are applied across different instruments. However, there were intense negotiations between the EU commission and Parliament on one hand and the EU Council regarding 100% alignment of green bonds with the taxonomy.

Fostering interoperability of Taxonomies is a priority for the sustainable finance agenda as concerns arise regarding market fragmentation and greenwashing risks under different approaches: A taxonomy for sustainable finance is a set of criteria that can be used to support the alignment of investments with sustainability goals. The EU has been a pioneer in the taxonomy space, issuing a climate taxonomy that has become an important reference for other countries. Other countries followed and Mexico recently became the first country to issue a sustainable finance taxonomy that includes climate and gender equality objectives. Besides taxonomies (which are asset centred) instrument-based alignment tools (ratings, labels, certifications) and portfolio-level approaches (indices and benchmarks, alignment metrics and portfolio tools) have developed. The different approaches and use of different tools generally reflect different regulatory frameworks, policy priorities, use cases, and choices of methodologies. Concerns also arise that the proliferation of taxonomies may generate market fragmentation, increase transaction costs, create data inconsistencies, and result in greenwashing risks.

Review of the different taxonomies underline important differences in approach. Few taxonomies use a common definition of carbon neutrality; few clarify the scope at which emissions are measured (within firm, or along the value chain); different approaches for determining substantive contribution to primary goals not always based on emission thresholds or with different approaches to calculate those thresholds; different approaches for incorporation of "do no significant harm" to other sustainability goals principle (DNSH); and different approaches for addressing transition considerations among others. Furthermore, few taxonomies are of mandatory use or require external verification.

The G20 Sustainable Finance Roadmap of 2021 encourages jurisdictions that intend to develop their own alignment approaches to **refer to a set of voluntary principles** (see below) **and invited international organizations to work on** and further understand the technical aspect and foundational elements of existing and emerging alignment approaches, and on **identifying interlinkages and best practices to enhance interoperability**. A recent paper by the BIS, IMF, OECD and World Bank are working on a paper to operationalize these principles[1]. The Common Framework for Sustainable Taxonomies in Latin America and the Caribbean also provides advice on the operationalization of this principles with a focus on emerging and developing countries[2]. In this operationalization, **the EU taxonomy is an important reference**, as it was for the formulation of the principles for example regarding the incorporation of do no harm considerations, the establishment of permanent taxonomies governance committees (part of guidance under principle 3), or the call for mandatory disclosures (under principle 4). Other proposed guidance differs from the current EU approach, for example requiring simplified disclosures for small and medium size business (SMEs), albeit this would soon be introduced in the EU for the listed ones.

[1] .https://www.worldbank.org/en/topic/financialsector/publication/activating-alignment
[2] https://www.unepfi.org/publications/common-framework-for-sustainable-finance-taxonomies-for-latin-america-and-the-caribbean/

- Principle 1: Ensure material positive contributions to sustainability goals and focus on outcomes.
- Principle 2: Avoid negative contribution to other sustainability goals (e.g., though do no significant harm to any sustainability goal requirements)
- Principle 3: Be dynamic in adjustments reflecting changes in policies, technologies, and state of the transition.
- Principle 4: Reflect good governance and transparency.
- Principle 5: Be science-based for environmental goals and science- or evidence-based for other sustainability issues.
- Principle 6: Address transition considerations.

The purpose of operationalizing the principles is not to create a global taxonomy but a common taxonomy framework that ensures all taxonomies have the same fundamental characteristics while providing flexibility to different jurisdictions to implement the principles in line with capabilities and level of ambition.

This global taxonomy framework should aim to provide a minimum common ground for some issues and options for enhancement. For example, with respect to DNSH the minimum ground requires compliance with international conventions on labour, human rights, and the environment as well as regional and national regulations. Option 1 involves application of well-defined risk management approach (e.g., IFC performance standards) or the inclusion of a set of ES issues. The latter involves managing the impact of the activity on other environmental areas (e.g. such as pollution, biodiversity, circular economy) as well as social (e.g. labour practices, occupational health and safety, community health and safety, climate change adaptation and resilience, land use and resettlement, gender, rights of indigenous peoples, cultural heritage etc). The second more ambition option would involve application of OECD responsible business conduct to cover supply chain issues.

New global standards related to ESG factors will continue to evolve, following the formation of the International Sustainability Standards Council. This will help to address what may be the biggest obstacle to accountability: **the lack of a common baseline for consistent disclosure standards (and thus disclosures by companies) across jurisdictions and industries.**

- Investors need comparable, consistent and meaningful information to make decisions. It can be argued that the most important element to address sustainability, to discourage inappropriate behaviours, such as greenwashing, and to promote sustainable investments is **transparency and standardization of certain minimum disclosures**, that is, **the provision of reliable, and quality information**, since only with good information can market participants identify and quantify risks, incorporate them into pricing and investment decisions. A 2022 survey by the Task Force on Climate-related Financial Disclosures (TCFD) identified consistent reporting on climate goals as one of the most important areas for businesses to improve. In the EU, directive NFRD introduced this obligation for large companies. The new European directive CSRD modernises and strengthens the rules about the social and environmental information that companies must report. CSRD will extend the scope of disclosure a broader set of large companies, as well as listed SMEs, - approximately 50 000 companies in total- and will require third-party review of the information. However, despite efforts to create common reporting standards across jurisdictions, differences persist, which can make it difficult to assess and compare corporate promises. A recent MSCI report collects the conclusions of the comparison of the proposals of the three most important climate disclosure standards: the ISSB, the EFRAG and the SEC. The report concludes that the European standards proposed by EFRAG are the most detailed, and that, while some progress has been made towards more consistent and comparable climate disclosure standards, this clearly remains a work in progress.

- For quality information, it is **imperative that ESG ratings are reliable**. There is a new and growing market of ESG rating providers that provide an opinion on the sustainability profile or characteristics of a company or financial instrument, exposure to sustainability risks or impact on society or the environment. The European Commission has launched a project to regulate this activity, as well as to ensure that credit rating agencies, which assess the creditworthiness of a company or financial instrument, incorporate relevant ESG risks into credit ratings. Other jurisdictions such as UK and Japan are proposing regulatory initiatives in line with recent IOSCO recommendations to improve ESG data and ratings providers' practices promoting regulatory oversight and measures to mitigate potential conflicts of interest, increase the integrity, transparency, and independence of ESG ratings and methodologies and disclosing sufficient information to allow the market to understand methodological approaches.

- Research indicates that **ESG rating criteria used by prominent agencies lacks commonality in the definition of ESG** (i) characteristics, (ii) attributes and (iii) standards in defining E, S and G components. Heterogeneity in rating criteria can lead agencies to have opposite opinions on the same evaluated companies. Low correlation in the scores provided by the rating agencies disperses the effect of preferences of ESG investors on asset prices, to the point that even when there is agreement, it has no impact on financial performances[3]. To some, a low correlation is a healthy and useful outcome from ESG rating providers noting the distinction between ratings and raw data. On the other hand, simplicity and correlation could bring credibility to ESG ratings as a discipline and give more consistent messages to companies. The International Sustainability Standards Board (ISSB) will establish a global baseline for ESG disclosures n enhancing comparability of company performance which could foster alignment across the key ratings providers and. Thee ISSB's cross-jurisdictional working group would help move towards a globally-accepted ESG reporting framework.

- **Accessibility to sustainability information**. For transparency to be truly effective, it must be easily accessible and treatable. An ambitious initiative in this area is the one launched by the European Commission to have a Single Access Point (ESAP) that will allow all the financial and non-financial information, including sustainability-related information, published by European companies, including small companies, to be concentrated in a single platform, in digital format, free and user friendly.

[3] *Billio, Monica, et al. "Inside the ESG ratings:(Dis) agreement and performance." Corporate Social Responsibility and Environmental Management 28.5 (2021): 1426-1445.*

Final Report
Overcoming the main ESG investing challenges

- The discipline of transparency also works in the field of **corporate governance** to ensure that ESG factors are integrated into day-to-day management and a long-term vision. In the EU a legislative framework has been recently approved to oblige companies — including those in financial services — to demonstrate what action they are taking to protect the environment and human rights. These duties include impacts in the company's own operations, their subsidiaries, and their value chains. Also, stewardship codes are becoming increasingly important in contributing to achieve positive impacts on society and on companies through a greater engagement of shareholders in the life of the companies in which they invest. The recent Stewardship Code promoted by the CNMV (February 2023) joins the proliferation of codes that already exist at an international level (more than 20 countries, seven of them European, have drawn up stewardship codes, including Australia, Brazil, Canada, Denmark, Germany, Hong Kong, India, Italy, Japan, Kenya, Malaysia, Netherlands, Norway, Singapore, South Africa, South Korea, Switzerland, Taiwan, Thailand, the United Kingdom and the United States).

- **Regulatory interest in fund names and fund classification and disclosure requirements are increasing globally**. Spearheaded by the EU's Sustainable Finance Disclosure Regulation (SFDR), which imposes requirements on more transparent reporting for ESG funds, other major market regulators are following suit. In the coming years, we will see the development of stricter disclosure regimes. Countries such as Australia, Hong Kong and Singapore, for example, have provided guidance to standardize disclosure on the integration of ESG factors into the investment selection process. The United States has made a similar but not directly comparable proposal, a significant move for the world's largest fund market. If these proposals come into force, for investors, this could mean better-informed decisions.

The ESG agenda is experiencing backlash due to political, geopolitical and social considerations which are also shaping regulatory initiatives. In the aftermath of the war in Ukraine, rising gas and energy prices have become a key factor linking inflation to the financial industry's efforts to combat global warming and other social problems. This trend, which has been described as anti-ESG sentiment, started in 2022, continues to rise in 2023 and is gaining momentum in countries like the US where it has become a new political front in a battle against restrictions on fuel industries and relaxing environmental standards in favour of energy independence. In this context, Vanguard's departure from membership in the Net Zero Asset Managers Alliance and more recently statements from companies such as Blackrock, JP Morgan or Elon Musk himself are understood.

As ESG-related commitments have begun to attract negative attention from a portion of investors and policymakers, some companies are choosing to downplay those statements to avoid this negative attention. We are thus witnessing a movement contrary to what is known as greenwashing, "**greenhushing**" (some studies estimate around 25% of companies that, despite following ESG strategies, prefer to minimize or not make such objectives public to avoid greenwashing accusations and scrutiny of their green credentials. The phenomenon known as "**greenbleaching**", a term used for example when a provider of investment services or products that is in practice "green" chooses not to claim that it is to avoid extra regulatory requirements and a potential regulatory or legal risk, may also be contributing to this withdrawal of the vanguard in ESG activism. Investors and consumers increasing use litigation before national courts and complaints to test whether companies live up to their claims which may be contributing to these developments.

Geopolitical and social considerations also have an important effect in taxonomies providing scope for greenwashing. In the EU, the Ukraine war factored into the decision to include gas and nuclear energy as sustainable activities, to provide cheap energy alternatives to EU companies during the transition towards renewable energies. But even without the war, with the reliance of some influential EU members on gas and nuclear it would have been difficult to reach an agreement on their exclusion. However, the inclusion is not without conditions[4]. Nevertheless, this inclusion has been heavily criticized and opposed by climate activists and some green investors that considered the inclusion greenwashing. Social considerations also play a key role on shaping taxonomies in fossil fuel exporting countries. Canada will soon publish a taxonomy that sets criteria for investable transition activities. New coal, oil and gas projects are excluded but existing oil and gas projects could be labeled 'transition' if they have limited lifespans and result in a real reduction in CO2 emissions. Critics are concerned about the proposed inclusion of carbon capture, utilization, and storage (CCUS) technologies for oil sand production, as well as the production of blue hydrogen produced from natural gas which will extend as opposed to wind down fossil fuel activities.

PROPOSALS AND CONCLUSIONS

International cooperation through the issuance of regulatory standards by standard setting bodies that provide a common framework for disclosure of ESG factors, classification of activities and labelling regulations are key to support sustainable finance development, set a level playing field among different jurisdictions and provide certainty to investors. Currently ESG factors have a prominent role in the international regulatory agenda, and the effort is welcomed by country regulatory investors and market participants. The EU is a leader in the ESG regulatory front and EU regulation is informing standard setting efforts. Institutions such as ESMA at EU level or IOSCO, FSB, IFRS, ISSB or NGFS at global level, play a key role in ensuring effective transparency and convergence in interpretative criteria and supervisory practices within and across market sectors and segments.

[4] *Existing nuclear power plants can attain green credentials under the Taxonomy if they phase in accident-tolerant fuels and develop sophisticated plans for storing and disposing of waste products in the long-term. Gas sector products must meet emissions caps and commit to reduced-carbon gases in the future.*

Common frameworks rest on the application on high level principles that ensure a minimum common standard. The operationalization of such principles typically envisions different approaches to accommodate the realities of different jurisdictions. This is the approached follow for example in the context of application of the Basel Capital Accord for International Active Banks. The ongoing work on the operationalization of the G20 high level principles for taxonomies builds on this tradition and would help fostering interoperability of taxonomies while responding to country needs.

Maximising regulatory alignment is not only desired across borders but also withing borders to provide certainty to investors and avoid regulatory arbitrage and greenwashing. Alignment of green bond regulations/guidelines with ESG labels and taxonomy regulations as well as consistency with company disclosure regulations are key to ensure a coherent sustainable finance ecosystem and reduce legal and supervisory risks for firms. To the extent that international regulatory standards increasingly inform local regulations, the alignment of international standards in different topics will support coherence of national regulatory frameworks. **The regulatory framework needs to mature, key concepts need to be clarified and sustainability impact or engagement needs to be better integrated.**

Adoption of science-based criteria that ensure activities considered sustainable do not compromise attainment of net zero goals is key to reduce greenwashing while accommodating transition considerations.

Enhanced financial education and clear explanations of what products do and do not do, and improving investor education will contribute to better expectation management, ensuring that products match investor expectations, and ultimately reduce the potential for greenwashing as well as litigation. Among some types of investors, particularly retail ones, there is a clear preference for profitability over sustainability, which has been evidenced in the green MiFID implementation process and the obligation for entities to identify the sustainability preferences of clients. There is often a mismatch between what a product aims at and investor expectations. To mitigate these risks, participants across the sustainable investment value chain must make informed claims and communicate about sustainability in a balanced way. There is a need to improve the understandability of sustainability disclosures for retail investors, including by establishing a well-designed and reliable labeling scheme for financial products. While market participants may move forward alone, **there is a clear benefit in collaborative action between industry and regulators to create an environment for progress across the sustainable investment value chain.**

MEMBERS

This document is the result of the work carried out by the Working Group members. It also reflects the contributions made by the Oxford/23 Congress participants during the congress' deliberations and in the review phase afterwards.

Working Group Leaders

- **María José Gómez Yubero**, Head of Resolution, Benchmarks and Financial Stability Issues at the National Securities Market Commission (CNMV).
- **Eva M. Gutierrez García**, Lead Financial Economist in the Latin American and Caribbean Region of the World Bank. Member of Fide's International Academic Council.
- **Mike Clark**, Founder Director, Ario Advisory.

Technical coordinator

- **Ana Rivero Fernández**, Global Technical Coordinator of the Global ESG Think-Tank - GET-2.

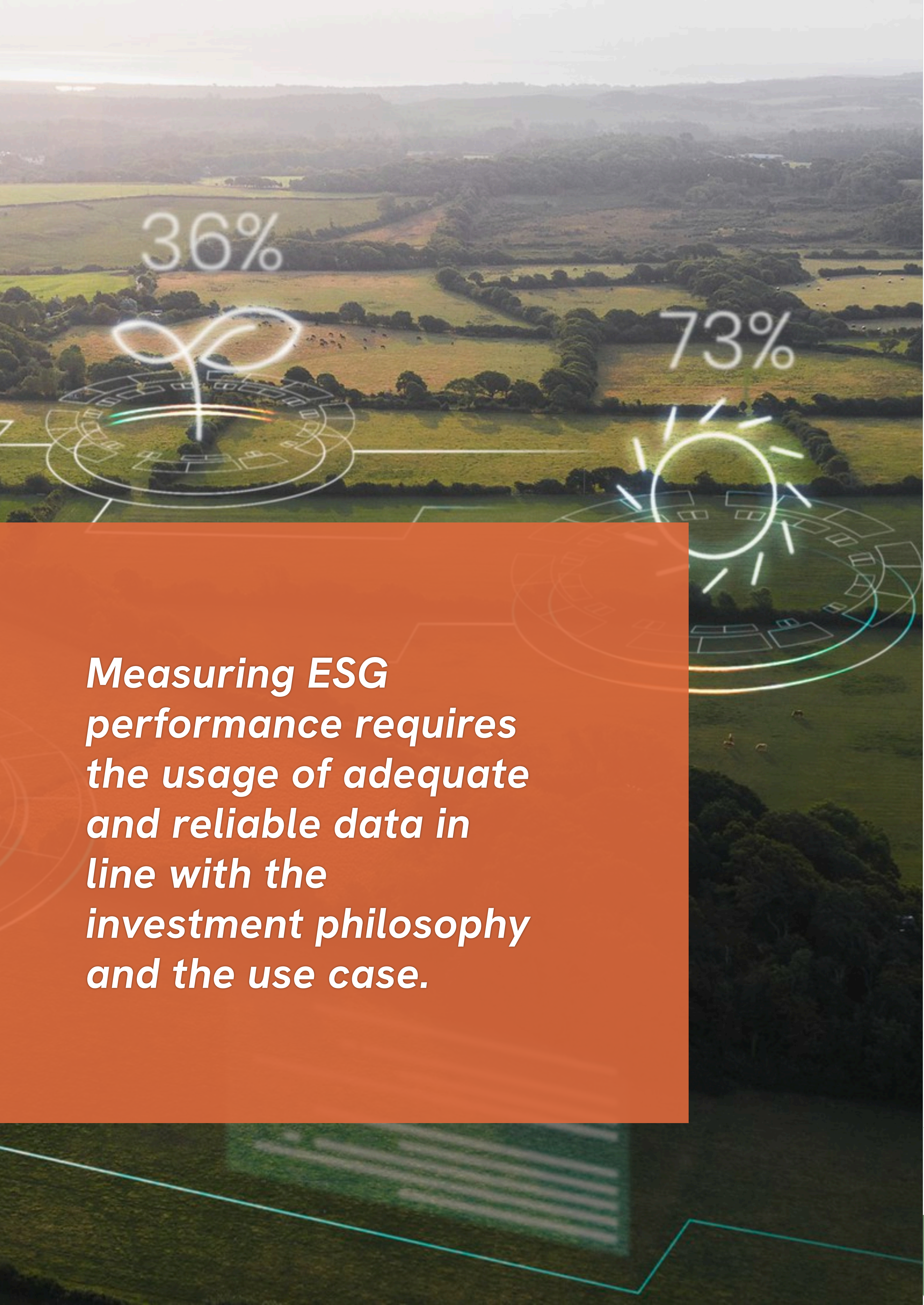
Members

- **Clotilde Bobineau**, SRI Analyst at VidaCaixa
- **Carolina Fernández**, Legal advice Inverco
- **María Pilar Galán Gavilá**, Partner Head of Financial Services Legal at KPMG Spain
- **Andrea González González**, Deputy Director General at SpainSIF
- **Eva M. Gutiérrez**, Lead Financial Economist at the World Bank
- **Ana Guzmán Quintana**, Head of Impact Investments, Portocolom AV
- **Sara Margarita Hernández Hernández**, Project Leader in the General Directorate of Financial Risk Management at CONSAR
- **Naomi Kwan,** Sales Support and interest in ESG at M&G
- **Carlos Montalvo Rebuelta**, Partner PwC
- **Eric Osio Cerón**, General Director of Risk Management at CONSAR
- **Laura Palomo Aguado**, Legal Advisor at the Spanish Association of Collective Investment Schemes and Pension Funds (Inverco)
- **Ignacio Rodríguez Añino**, Responsible for the Commercial Development of M&G Investments in Spain and Latin America
- **Laura Sacristán Martín**, Chief Commercial Officer at Grupo BME-SIX

Final Report
Overcoming the main ESG investing challenges

This report is signed in a personal capacity and does not represent the official position of the institutions or entities to which the members of the group belong.

Oxford Congress 2023
OVERCOMING THE MAIN ESG
INVESTING CHALLENGES



Measuring ESG performance requires the usage of adequate and reliable data in line with the investment philosophy and the use case.

GET[2]
Global ESG Think-Tank
Finance and Law Engaging our Society

FINAL REPORT

Oxford/23: Overcoming the main ESG investing challenges

ESG key metrics and ratings

Working Group 2 Report

WG 2 Report:

ESG key metrics and ratings

ABSTRACT

ESG data have become centre stage for investment decisions and reporting to end-beneficiaries. Today, a significant amount of ESG metrics and ratings are available to answer specific questions, such as the nature and extent of a company's exposure to harmful or green products and services, operational risks, corporate scandals or governance practices. However, the ambiguous nature of definitions combined with a lack of standardisation contribute to common misunderstandings and misinterpretations when using ESG data. This paper aims at providing some clarity on ratings and metrics typically used at issuer and portfolio level for listed equity, corporate and sovereign bonds, demystifying what they represent, their limitations, and their practical applications such as measuring positive and negative impacts of investments on the environment and society. Throughout this paper, the authors maintain a provider-agnostic perspective.

Keywords: *ESG data providers, ESG rating, ESG data, ESG metrics, EU Taxonomy, SFDR, Sustainable Investments, Principal Adverse Impacts*

INTRODUCTION

The rise of investors' demand for ESG investment products and the intensification of regulatory requirements and climate disclosures drove the global ESG data spending in 2021 above the US$ 1bn threshold with a CAGR of 28% over the previous five years[5]. A trend which is expected to persist during the next few years. On the supply side, the landscape looks crowded, yet highly concentrated, with the main three ESG data providers, MSCI, Sustainalytics, and ISS ESG accounting for 60% of the market.

This paper covers the 70% of the global ESG budget spent on ESG ratings, metrics and other dedicated data solutions, as opposed to the 30% disbursed on ESG indices. More specifically, this paper provides an overview of datasets used to assess the ESG performance of companies based on the double materiality concept. The notion of double materiality captures **financial risks and opportunities** arising from environmental and/or social (E/S) issues which affect the value of economic agents, as well as the **negative and positive impacts** on the environment and society of economic activities.

Exhibit 1 – Double materiality

Source: Pictet Asset Management

These two dimensions of materiality are often interconnected. For example, a company emitting greenhouse gases is contributing to a negative environmental impact (global warming) and may see its economic value decline due to a combination of carbon taxes and extreme weather events. While ESG ratings have become increasingly popular among investors to evaluate financial materiality, regulatory developments have led to the selection of key metrics aimed at measuring positive and negative impacts of investments on society and the environment, such as Sustainable Investments and Principle Adverse Impacts provided by the European legislators through SFDR[6].

[5] *Opimas, ESG data is now worth it, https://www.opimas.com/research/742/detail/*
[6] *Sustainable Finance Disclosure Regulation*

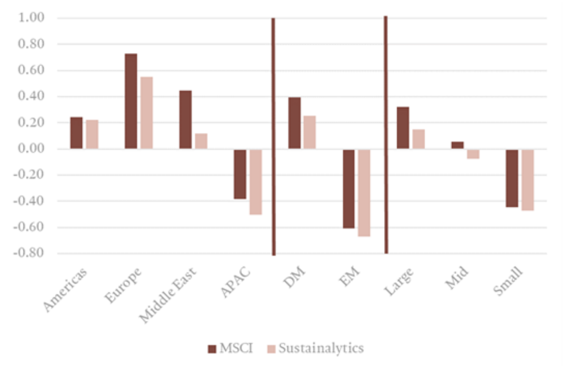
PART 1 - ESG RATINGS

What ESG ratings are

ESG ratings assess a company's performance across a broad spectrum of ESG areas. From environmental impact and climate change policies, to human rights, labour standards, and corporate governance structures. ESG ratings' providers use different criteria and methodologies to assess how well issuers are addressing these issues, and condense numerous ESG indicators in the form of a single score or rating mainly aimed at gauging the **financial risks and opportunities** that this could have on the economic value of an issuer.

It is often stated that ESG ratings exhibit biases across regions and sectors. In particular, larger companies typically have better ratings than small companies, and emerging markets have weaker ratings than developed markets[7]. Generally speaking, differences can be perceived more across regions than size segments as shown in Exhibit 2.

Exhibit 2 – Average Z- scores by region and market cap



Source: MSCI, Sustainalytics, Pictet Asset Management

Unlike metrics such as Principle Adverse Impacts (PAI) indicators or the percentage of alignment with the EU Green Taxonomy, ESG ratings are not inherently conceived to measure positive or negative impacts of specific economic activities on society or the environment.

Diverging ESG Ratings

Although ESG ratings from different providers aim at achieving the same objectives, the underlying philosophies and construction methodologies of such ratings can vary considerably, leading to vastly different conclusions for the same companies or portfolios. This is reflected in the correlation among ESG ratings from different providers, which is significantly lower than credit ratings, i.e., 54% correlation on average[8] compared to 95% for credit ratings from the agencies Standard & Poor, Moody's, and Fitch[9].

---

[7] *See for instance Doyle (2018)*
[8] *Berg et al. (2022), "The Aggregate Confusion: The Divergence of ESG Ratings"*
[9] *Kevin Prall, CFA, "ESG Ratings: Navigating Through the Haze"*

Berg et al. (2022) identified the scope, the measurement, and the weights used in the aggregation processes as the main sources of divergence across six ESG ratings providers in their paper "The Aggregate Confusion: The Divergence of ESG Ratings". Based on their research, different measurement approaches contribute to 56% of the divergence, while scope and weight contribute 38% and 6%, respectively.

Such low correlation reflects the subjective nature of ESG ratings, hence ESG ratings should be considered as opinions or recommendations rather than a universal viewpoint.

Use cases

While low correlation between ESG ratings can pose challenges for users in terms of comparability and consistency, there are potential benefits for active investors. By comparing multiple ESG ratings, or developing proprietary methodologies, investors can gain a more comprehensive understanding of a company's ESG risks and opportunities, allowing them to explore different aspects of sustainability and potentially uncover hidden risks or opportunities. Combining insights from different and complementary viewpoints can also help users identify areas of consensus and disagreement, providing a more nuanced view of a company's fundamental strengths and weaknesses, thus exploiting market inefficiencies.

For passive investors, ESG ratings are typically used to construct indices that exclude issuers with weaker ESG ratings or focus on the ones with stronger ESG ratings, e.g., the top 50% or higher weights to better rated companies within each sector or across a broad universe. As for traditional indices, ESG indices may also be based on a specific market, sector, or geography. For example, an ESG index could focus on large-cap companies in the United States, or on the global technology sector. Because issuer-level ESG ratings vary across providers, this can lead to different index compositions also among indices that have similar investment objectives.

For fund selectors, portfolio-level ratings, which are based on issuer-level ESG ratings, provide an aggregated view of the ESG performance of the underlying companies of a given portfolio. This enables investors to effortlessly compare and select portfolios, while enhancing transparency on ESG considerations in client reports. Worth noting that the low correlation between ESG ratings at issuer level is prone to be compounded at portfolio level due to different aggregation approaches among providers, which can result in wider divergences for similar portfolios.

Limitations of ESG Ratings

As mentioned above, ESG ratings use different philosophies and methodologies to assess financial risks and opportunities. Such methodologies are not always fully disclosed in a transparent way, making it difficult for users to grasp how ratings are calculated, and assess their quality and robustness.

Moreover, the very attempt of condensing a multitude of ESG indicators into a single number through a series of weighted averages constitutes another important disadvantage of ESG ratings. In reality, companies or countries overall performance depends upon numerous factors, some more critical than others. Averaging multiple, uncorrelated ESG characteristics assumes that weaknesses in some areas (e.g. high lost-time injury rate for companies or high infant mortality rate for countries) can be compensated by strength in unrelated areas (e.g. low greenhouse gas emissions). In reality, organisations are as strong as their weakest link. To cite a renowned investor "Never forget the 6-foot-tall man who drowned crossing the stream that was 5 feet deep on average"[10].

It is therefore crucial to clearly separate strengths from weaknesses. This may require more work and the disaggregation of ESG ratings into more granular ESG metrics, but ultimately, it should enable investors to better understand issuers, and integrate such insights in their fundamental analysis.

Lastly, ESG ratings at portfolio level should not be used as a barometer for measuring the robustness of fund managers' considerations of ESG factors in their investment processes. Fund-level ratings, only aggregate issuer-level ESG ratings, and might therefore – coincidentally – reflect the positive ratings of the underlying holdings at that given point in time.

---

[10] *Howard Marks, Memo to Oaktree Capital Management's clients (2020), https://www.oaktreecapital.com/docs/default-source/memos/you-bet.pdf*

PART 2 - ESG METRICS

So far, when looking at the ESG ratings, we have focused more on the financial risks and opportunities side. In this section, the focus is more on the other side of the double materiality concept, i.e., E/S impacts.

ESG metrics are a starting point to assess financial risks and opportunities arising from ESG issues, as well as measuring E/S impacts of economic activities, such as climate change, biodiversity loss, education, and healthcare. Some data providers offer a myriad of ESG metrics (e.g., board independence, GHG emissions, lost time due to recordable incident rates of the workforce), making it sometimes difficult for investors to select the most relevant and adequate indicators to assess material issues.

The move towards standardisation of ESG metrics has been gaining momentum with the use of international standards such as the ones developed by the Global Reporting Initiative (GRI) and the Sustainability Accounting Standards Board (SASB) which disclose comprehensive sets of indicators for businesses to report on. More recently, the IFRS Foundation set-up the International Sustainability Standards Board (ISSB), a new standard-setting board that is developing a high-quality, comprehensive global baseline on sustainability disclosures focused on the needs of investors and the financial markets.

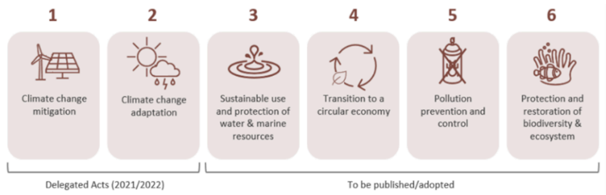
The ultimate goal of such initiatives is to create a more cohesive and consistent system by aligning what companies report and what investors require, thereby allowing for more accurate comparisons, assessments, and potentially, avoid false advertisement. Although these frameworks have different focus areas (e.g., financial materiality for SASB and E/S impact for GRI), with time, they should converge[11], allowing reporting bodies to track sustainability-linked developments in a more holistic way.

Further to the above-mentioned standards, regulations such as the EU Green Taxonomy (2020), Sustainable Finance Disclosure Regulation (SFDR)[12], and Corporate Sustainability Reporting Directive (CSRD)[13] have become instrumental in standardising ESG metrics disclosure requirements for companies and investors. These regulations bring to the fore a series of metrics for measuring negative impacts (so called **Principal Adverse Impacts** or "PAI" indicators) and provide common guidelines for gauging positive impacts through **Sustainable Investments**. The objective of such metrics is to improve transparency and comparability thanks to standardised sets of sustainability KPIs reported by companies in scope, which in turn should allow investors to portray a more balanced picture of issuers by considering both positive and negative E/S impacts.

---

[11] *GRI and SASB (2021), "A practical guide to sustainability reporting using GRI and SASB standards", https://www.globalreporting.org/media/mlkjpn1i/gri-sasb-joint-publication-april-2021.pdf*
[12] *The that requires FMPs to declare the extent to which funds and mandates incorporate ESG considerations (also known as Article 6/8/9) and, as of 2023 to disclose their exposure to "Sustainable Investments", i.e. economic activities that contribute to an environmental or social objective.*
[13] *The (CSRD) requires approximately 50'000 European companies to start disclosing as of January 2024 a core set of ESG metrics, including revenue generated from economic activities eligible (and at a later stage aligned) to the Green Taxonomy. This will be achieved by leveraging the European Sustainability Reporting Standards (ESRS) developed by EFRAG, which will provide the reporting framework and methodologies needed to meet CSRD's requirements*

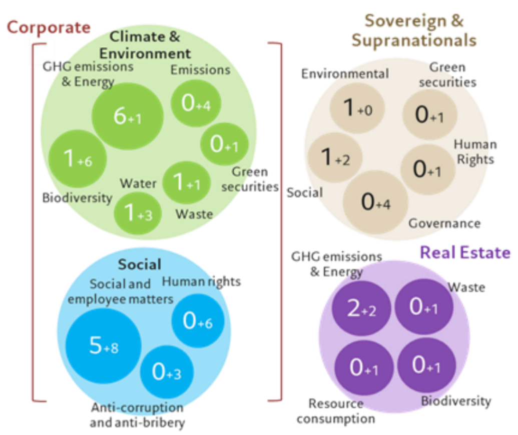
Exhibit 3 - The environmental objectives of the Green Taxonomy



Source: European Commission, Pictet Asset Management

Sustainable Investments consist of economic activities that "substantially" contribute to an environmental objective without causing significant harm to other ones ("DNSH"). In addition, they must respect minimum social safeguards. This is what is known as the European Taxonomy of sustainable activities ("the Green Taxonomy"), which aims to assess tangible **positive environmental impacts** of companies (see Exhibit 3).

Exhibit 4 - 18 Mandatory and 46 voluntary PAIs



Source: RTS, Pictet Asset Management, 31.08.2022

Principal Adverse Impacts consist of a list of common metrics embedded in CSRD and SFDR to measure the **negative E/S impacts** of investment decisions and thereby complement the measure of positive contribution through Sustainable Investments. Financial Market Participants (FMPs) have to declare how investment decisions adversely impact society and the environment through a series of mandatory and voluntary indicators. PAIs include topics such as greenhouse gas emissions, energy consumption, air and water pollution, biodiversity loss, hazardous waste, workplace accidents, discrimination, human rights violations, and corruption. For sovereigns, these include topics such as greenhouse gas emissions, human rights violations, and income inequality (see Exhibit 4).

Final Report
Overcoming the main ESG investing challenges

Use cases

Specific considerations of PAIs and Sustainable Investment allow investors to define their investment universes by using, for example, negative and positive screening processes in order to exclude companies involved in harmful activities (e.g., fossil fuel exposure) and promote environmentally sustainable ones (e.g., renewable energy production), respectively, or by promoting transitional strategies that aim to increase the positive impacts of currently not-so-green companies.

With aggregated PAIs and Sustainable Investments metrics at portfolio level, distributors of investment products are able to assess their "greenness" and compare them to their peers, as investors in scope of SFDR will have to disclose the percentage of Sustainable Investments and how they consider PAIs. These metrics, in addition to the existing ones (e.g., ESG ratings, involvement in harmful businesses activities or violations of internal norms), allow investors to depict a more holistic and squared picture of the investment products that claim to be sustainable or ESG. Investors can also report on PAIs and the percentage of Sustainable Investments in fund annual reports made available to end beneficiaries.

Under the Markets in Financial Instruments Directive 2014, commonly known as MiFID 2, investment advisors and wealth managers will have to consider their clients' sustainability preferences (for those who wish to) when choosing which investment advice or products are most suitable for them. Preferences are assessed by considering PAIs and Sustainable Investments.

Limitations of ESG Metrics

The single largest obstacle investors are facing today is a chronic shortage of reported data, which results in poor coverage of their investment universes. Under SFDR, FMPs are expected to report as of 2023 investments in Taxonomy-aligned economic activities at portfolio level, based on the alignment of their investee companies. However, as per CSRD, companies in scope of the regulation[14] will be required to report their alignment with the Taxonomy only as of January 2024. This time lag between enforcement of SFDR and CSRD is already creating a lack of taxonomy-aligned data in the market. For PAIs, as of September 2022, half of the indicators applicable to companies had a coverage of less than 50% of MSCI ACWI IMI[15]. The limited coverage is mainly caused by the fact that companies falling under the scope of CSRD will only be required to report environmental and social impacts data as of January 2024. At the same time, part of the European Taxonomy (Green and Social Taxonomies) and the PAIs are still work in progress.

[14] Companies in scope of the CSRD are (i) European companies with more than 500 employees (ii) companies with securities listed on an EU-regulated market, and (iii) companies that have more than EUR 150mn of revenue in the EU and at least one subsidiary or branch in EU.
[15]

This issue is exacerbated by regional challenges affecting the relevance of certain ESG metrics. For example, water scarcity is an issue which will be much more relevant in countries experiencing regular droughts compared to countries where rainfall is expected to increase. Another example is the interpretation of ESG issues that are closely connected to political considerations, cultural values, or societal models such as human rights, private healthcare or climate change.

Over time, we expect the situation to improve, although data gaps are likely to remain, as CSDR applies mainly to companies with a presence in Europe, whereas SFDR applies to all portfolio holdings, irrespective of geography. This problem is particularly acute for global portfolios for which over two-thirds of investee companies are not European.

Another issue is linked to the very definition of Sustainable Investments. In Europe, different pieces of legislation (i.e., the Green Taxonomy and SFDR) provide two definitions based on the same concepts but described at different depths. While the Green Taxonomy provides highly granular definitions and technical screening criteria, Art.2 (17) of SFDR provides only a guidance. The latter is bound to lead to significant divergences in the percentage of sustainable investments across portfolios, mainly caused by the different scopes, measurements, and data sources. For example, different investors could end up including different economic activities (e.g., private v. public healthcare or education) in their definition of Sustainable Investments. The possibility of obtaining different percentages of alignment to sustainable investment due to diverging definitions, raises the risk of false advertisement for investors.

Even though the intention of the legislators is to increase transparency and standardise the use of key ESG metrics, this is still an evolving space with expected amendments and burgeoning of additional – and potentially incompatible – regulations at national or regional level.

POTENTIAL RISKS IN THE ESG DATA SPACE

In recent years, large players such as MSCI, Morningstar, Bloomberg, Standard & Poor, London Stock Exchange Group and Moody's have been acquiring smaller ESG data providers, further consolidating their dominant positions. This level of concentration raises the spectrum of an oligopolistic market, with the associated risks of higher prices, lack of innovation, and quality issues. In addition, some ESG data providers may offer second-party opinions or consultations on company's ESG strategy. This could result in conflicts of interest, as the companies may get advice on how to improve their ESG ratings.

As a result of the aforementioned risks and the potential lack of transparency on underlying methodologies, some jurisdictions (e.g., European Union, the United Kingdom, Hong Kong SAR, Japan) have considered the implementation of guidelines for ESG data providers. The European Commission, on 13 June 2023, the presented a proposal on a Regulation.

Final Report
Overcoming the main ESG investing challenges

ESG ratings have an increasingly important impact on the operation of capital markets and on investor confidence in sustainable products. The market of ESG ratings is expected to continue to grow substantially in the coming years.

According to Commission, the current ESG rating market suffers from deficiencies and is not functioning properly, with investors and rated entities' needs regarding ESG ratings are not being met and confidence in ratings is being undermined.

This problem has a number of different facets, mainly (i) the lack of transparency on the characteristics of ESG ratings, their methodologies and their data sources and (ii) the lack of clarity on how ESG rating providers operate. ESG ratings do not sufficiently enable users, investors and rated entities to take informed decisions as regards ESG-related risks, impacts and opportunities.

CONCLUSIONS

ESG ratings and metrics have become a "must have" for investors but should be used with caution to make informed investment decisions and effectively utilise the insights offered by different sources. It is key for users to conduct thorough research and understand the approaches behind. Hence, access to transparent disclosures of methodologies and philosophies of ESG ratings is paramount.

Even though ESG ratings can be a useful way to summarise a large number of ESG indicators into one comprehensive rating for specific cases, they come with their limits. In particular, the aggregation of individual ESG signals bears the risk of hiding relevant information, when trying to depict the full sustainability profile of a company or investment product.

Finally, international reporting frameworks and regulations that promote the use of more standardised sets of ESG metrics are set to play a central role in enabling investors – who intentionally consider sustainability as part of their investment philosophy – to gauge ESG risks and opportunities, and mitigate the negative impacts of their assets on society or the environment, while channelling investments to finance sustainable economic activities so as to accelerate the transition to a greener and more resilient economy. As for the ESG landscape, such frameworks are work in progress and more clarity could help preventing users from incurring into false advertisement risks.

REFERENCES

- Timothy M. Doyle (2018), "Ratings that Don't Rate (2018): The Subjective World of ESG Ratings Agencies", Harvard Law School Forum on Corporate Governance. https://corpgov.law.harvard.edu/2018/08/07/ratings-that-dont-rate-the-subjective-world-of-esg-ratings-agencies/
- Florian Berg, Julian F Kölbel, Roberto Rigobon (2022), "Aggregate Confusion: The Divergence of ESG Ratings", Review of Finance, Volume 26, Issue 6, 1315–1344.
- Chatterji, A. K., Durand, R., Levine, D. I., and Touboul, S. (2016), "Do ratings of firms converge? Implications for managers, investors and strategy researchers", Strategic Management Journal 37, 1597–1614.
- Kevin Prall, CFA, "ESG Ratings: Navigating Through the Haze", CFA Institute Blog. https://blogs.cfainstitute.org/investor/2021/08/10/esg-ratings-navigating-through-the-haze/
- The Sustainability Institute by ERM (2023), "Rate the Raters 2023 – ESG Ratings at a Crossroads" https://www.sustainability.com/globalassets/sustainability.com/thinking/pdfs/2023/rate-the-raters-report-april-2023.pdf

MEMBERS

This document is the result of the work carried out by the Working Group members. It also reflects the contributions made by the Oxford/23 Congress participants during the congress' deliberations and in the review phase afterwards.

Working Group Leaders

- **Eric Borremans**, Head of Environmental, Social & Governance, Pictet Asset Management.
- **Daniela Mohr**, Senior Responsible Investment Analyst at AFP Cuprum.

Technical coordinator

- **Ana Rivero Fernández**, Global Technical Coordinator of the Global ESG Think-Tank - GET-2.

Members

- **Víctor Augusto Cos Montiel**, CFA. Director of Risk Management Process Supervision and Financial Inspection at CONSAR.
- **Sandra Fernández**, Marketing & Client Servicing Manager at Pictet Asset Management
- **Pilar Galán Gavilá**, Partner Head of Financial Services Legal at KPMG Spain
- **Sara Margarita Hernández**, Project Leader in the General Directorate of Financial Risk Management at CONSAR
- **Rocío Jaureguizar Redondo**, Sales Manager and ESG Specialist at Pictet Asset Management
- **Eric Osio Cerón**, General Director of Risk Management at CONSAR
- **Valdemar Perot**, Investment Analyst at AFP HABITAT
- **Gonzalo Rengifo Abbad**, Head of Distribution - Iberia, LatAm at Pictet Asset Management
- **Gizelle Rivera Contreras**, Deputy Director of Financial Research at the Financial Vice-Presidency of CONSAR
- **Faisel Syed**, ESG Specialist at Pictet Asset Management

This report is signed in a personal capacity and does not represent the official position of the institutions or entities to which the members of the group belong.

The cost of transitioning from fossil fuels to a clean energy economy is significant, but the investment industry has a key role to play in promoting sustainable development and mitigating climate change.

GET[2]
Global ESG Think-Tank
Finance and Law Engaging our Society

FINAL REPORT

Oxford/23: Overcoming the main ESG investing challenges

To quantify the cost of transition from fossil fuels to a clean energy economy in terms of inflation, GDP or market performance expectation changes

Working Group 3 Report

WG 3 Report:

To quantify the cost of transition from fossil fuels to a clean energy economy in terms of inflation, GDP or market performance expectation changes

ABSTRACT

The transition from fossil fuels to a clean energy economy will be essential in global efforts to combat climate change over the coming years. In this paper, we explore the potential effects of the transition, and the factors which will influence it, primarily with regards to economic growth and inflation.

Keywords: *Energy, Transition, Greenflation, Net Zero, Economic Growth, Impact, Financial Markets*

THE CURRENT EMISSIONS GAP

The Emissions Gap 2022 report from the United Nations Environment Programme (UNEP) has highlighted just how far behind schedule the world is, in its aim to limit global warming to well below 2°C, but preferably 1.5°C above pre-industrial levels, in line with the goals of the Paris Agreement on Climate Change. Current policies point towards a temperature rise of 2.8°C by the end of the century, with current pledges potentially reducing this to 2.4-2.6°C[16].

The UNEP report stressed the need for 'wide-ranging, large-scale, rapid and systemic transformation' across sectors. With significant emissions stemming from the production of energy, the transition from fossil fuels to a clean energy economy will clearly play a significant role, if the world is to succeed in its climate efforts.

PHYSICAL AND TRANSITION RISKS

The risks of climate change can be split broadly into two categories: physical risks and transition risks.

- **Physical** risks are those related to the physical impacts of climate change, such as higher temperatures, rising sea levels and more frequent extreme weather events. The economic consequences will be far-ranging, from reduced production to increased input costs and the destruction of business assets.
- **Transition** risks are those associated with the transition towards a low-carbon economy. They could include changes in policy and regulations intended to reduce emissions, technological improvements, market dynamics, and reputational risks.

Physical risks and the transition to a clean energy economy are closely linked over longer timeframes. The scale and speed of the transition in the short term will influence the severity of physical risks in the longer term, while changes to forecasts of future physical risks will also impact the size and scale of the measures implemented today.

[16] *Emissions Gap Report 2022, United Nations Environment Programme, accessed April 2023.*

WHAT WILL THE TRANSITION LOOK LIKE?

The size, speed, and orderliness of the transition to a low-carbon economy, including the shift from fossil fuels to clean energy, will have significant ramifications for economic growth, inflation and financial markets. However, before considering these implications, we must first consider the different possible scenarios which may play out over the coming years.

The Network for Greening the Financial System (NGFS) climate scenarios framework is a set of six scenarios for tackling climate change, split into a number of categories.

Figure 1: NGFS scenarios framework

Source: NGFS Climate Scenarios for Central Banks and Supervisors, accessed April 2023.

Orderly scenarios assume climate policies are introduced early and become gradually more stringent, with both physical and transition risks relatively subdued. The **Net Zero 2050** pathway limits global warming to 1.5°C through strong climate policies and innovation, reaching net zero CO2 emissions by 2050. The **Below 2°C** scenario includes increasingly stringent climate policies, with a 67% chance of limiting global warming to below 2°C.

Disorderly scenarios explore higher transition risk due to policies being delayed or divergent across countries and sectors. The **Divergent Net Zero** pathway reaches net zero emissions by 2050, with higher costs due to divergent policies, and varying carbon prices, introduced across sectors. **Delayed Transition** assumes emissions do not decrease until 2030, followed by strong policies to limit warming below 2°C.

Hot house world scenarios assume that some climate policies are implemented in some jurisdictions, but globally efforts are insufficient to halt significant global warming. The scenarios result in severe physical risks including irreversible impacts like rising sea levels. The **Nationally Determined Contributions (NDCs)** pathway includes all currently pledged emission reduction targets, even if they aren't backed up by policies. Current Policies forecasts only currently implemented climate policies.

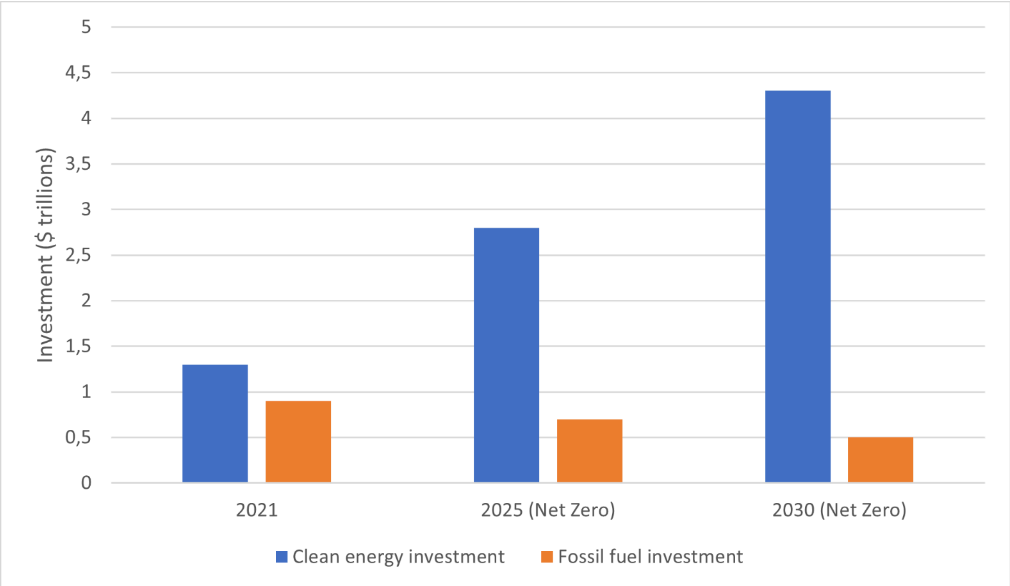
Currently, we believe the most likely scenario is a delayed transition, where energy and carbon intensity only fall after the impacts of climate change are experienced to a greater extent.

THE EFFECTS OF THE TRANSITION ON ECONOMIC GROWTH

The impact on economic growth will depend largely on the scale and speed of the transition, and the associated physical and transition risks. While there is much uncertainty, the numbers are nonetheless significant. According to Deloitte, inaction on climate change will lead to US$178 trillion of GDP destruction over the next 50 years, while achieving current global climate targets could yield US$43 trillion in economic benefits[17].

While physical and transition risks are expected to negatively impact global GDP, much-needed investment in the likes of infrastructure and clean energy technology should have a positive impact on economic growth. The International Energy Agency forecasts that annual clean energy investment will top $2 trillion by 2030 under current policies, increasing to above $4 trillion under Net Zero scenarios[18]. The ability of renewables to contribute towards maintaining a secure energy supply, without the potential geopolitical issues stemming from countries relying on others for their energy needs, will also encourage investment.

Figure 2: Clean energy and fossil fuel investment under a Net Zero scenario



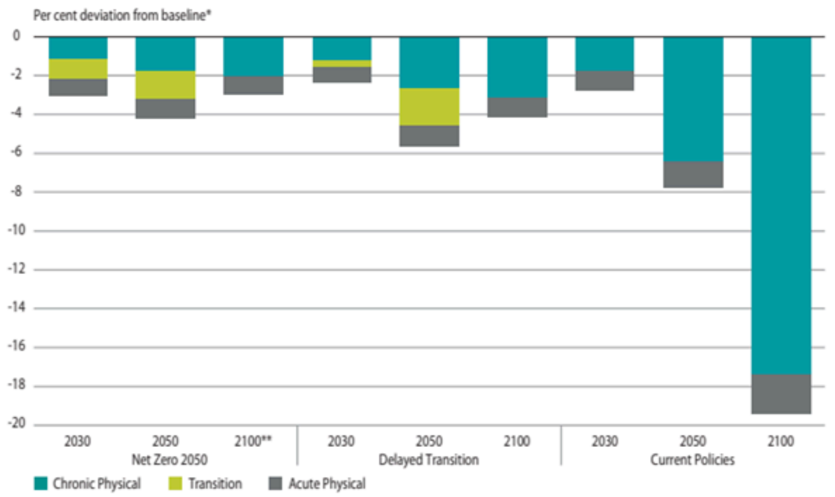
Source: NGFS Climate Scenarios for Central Banks and Supervisors, accessed April 2023.

[17] Global Turning Point Report, Deloitte Centre for Sustainable Progress, accessed April 2023.
[18] World Energy Outlook 2022, International Energy Agency, accessed April 2023.

Conversely, the implementation of carbon pricing or a carbon tax will affect GDP across most countries. The implementation of a carbon tax is generally accepted to be an effective method of cutting emissions. However, this may lead to higher costs and reduced margins for businesses, and to reduced consumption if higher costs are passed on to consumers.

The physical risks of climate change will also have an impact on economic growth, through the likes of damage to business assets and reduced productivity due to adverse weather. The extent of such damage will depend greatly on the speed of transition. Arguably, while a faster and stricter transition would increase the likelihood of reduced short-term economic growth from mechanisms such as a carbon tax, it would reduce the chance of economic damage from physical risks over the longer term.

Figure 3: GDP deviation due to transition, chronic and acute risks



Source: NGFS Climate Scenarios for Central Banks and Supervisors, accessed April 2023.

*The baseline is a hypothetical scenario with no transition or physical risks.

Final Report
Overcoming the main ESG investing challenges

HOW WILL INFLATION BE AFFECTED?

The massive investment required for the transition from fossil fuels to a clean energy economy is likely to lead to higher and more volatile inflation over the next decade, regardless of the pathway. This is known as 'greenflation'.

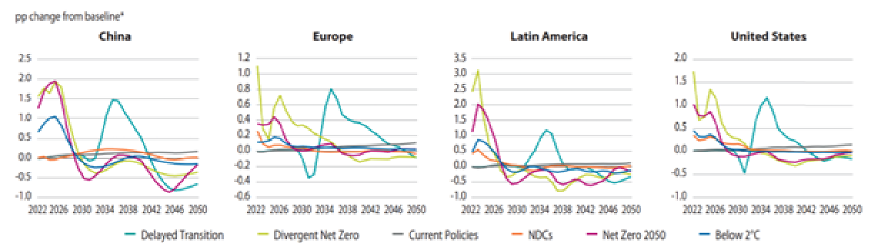
Another contributing factor to greenflation will be the supply and demand imbalance for metals which are used abundantly in the likes of wind turbines, electric vehicles and other clean technologies. As demand continues to increase, the growing supply gap projected for many key metals will drive up costs. This will only be exacerbated by geopolitical risks in certain countries where these metals are abundant, such as the Democratic Republic of Congo, which is home to 70% of the world's cobalt – a key material used in many electric vehicle batteries[19].

While the negative effects of persistently high inflation have been visible during the recent cost of living crisis experienced across large swathes of the world, greenflation is arguably an acceptable price to pay when compared to the alternative (see next section).

Again, the extent of greenflation will depend on the transition itself. A smooth, orderly transition should result in a smaller increase to inflation, whereas a disorderly transition could see higher prices through inefficient or contradictory global policies. Short-term inflationary pressures are also likely to be higher with faster transitions, as well as with a Net Zero pathway.

However, this poses the question of whether governments would be prepared to suffer the public unrest which may result from higher inflation. How would individual families cope with higher prices? And would governments subsidise this as part of their climate efforts?

Figure 4: Inflation effects across regions



Source: NGFS Climate Scenarios for Central Banks and Supervisors, accessed April 2023.

*The baseline is a hypothetical scenario with no transition or physical risks.

[19] *'Can the Democratic Republic of the Congo's mineral resources provide a pathway to peace?', United Nations Environment Programme, accessed April 2023.*

Oxford Congress 2023
OVERCOMING THE MAIN ESG INVESTING CHALLENGES

THE RISK OF DOING NOTHING

It is important to note that, while there will be inflationary effects from clean energy transition investment, inflation is likely to get worse if we do nothing. Global energy system disruption, resulting from the war in Ukraine, demonstrated the potential for geopolitical events to drive up the costs of fossil fuels. An energy system that continues to rely heavily on fossil fuels will be vulnerable to the same price volatility in the future. We can also expect the physical risks of climate change to drive further inflation. For example, extreme weather events damaging business assets and disrupting supply chains or shifting weather patterns affecting the production of food and other goods.

CENTRAL BANKS WILL PLAY A KEY ROLE

Central banks will likely play a pivotal role in climate transition efforts, depending on whether they are prepared to accommodate greenflation and cushion any volatility this may create. For example, will they be willing to internalise the inflationary costs of climate change efforts in their modelling, and take this into account when adjusting interest rates, or revise their inflation targets to accommodate for greenflation.

The risk is that by combating higher inflation with increased interest rates, central banks would impact vulnerable households, but also the financing of new projects, which will be key for a successful transition. Furthermore, in a high-rate environment, the private sector may demand greater rates of return to finance clean energy projects, which could delay or jeopardise much-needed investment.

BALANCING ENERGY SUPPLY AND DEMAND

When considering the transition, we must also acknowledge the arguably competing priorities of reducing emissions and promoting economic growth. As populations and economies grow, energy consumption is only going to rise in tandem. The US Energy Information Administration forecasts that energy demand will grow by 47% over the next 30 years[20]. The world will therefore require more energy from fossil fuels and other sources until there is adequate supply of renewable energy capacity.

After all, restricting energy supply without cutting demand will only create higher prices, as we saw in the wake of Russia's invasion of Ukraine. The increase in renewable energy capacity must therefore be met with efforts to reduce demand wherever possible, for example through implementing carbon pricing, or setting stricter minimum standards for energy-efficiency in buildings.

[20] *International Energy Outlook 2021, US Energy Information Administration, accessed April 2023.*

THE RISKS OF A DISORDERLY TRANSITION

It is important to note that climate change is a global phenomenon, which requires a consistent response across the globe. In the shorter term, one of the key risks to a successful energy transition - and the associated impacts on economic growth and inflation - is that of a disorderly transition. Unfortunately, we are currently seeing this play out.

When it comes to climate change, there are varying mindsets and priorities across the world. For example, in parts of the US we have witnessed a backlash against all things ESG, with several states punishing asset managers for boycotting fossil fuel investments. At the same time, Europe's Sustainable Finance Disclosure Regulation aims to improve transparency around sustainable investing.

Similarly, policy responses also vary between regions. In Spain and Portugal, governments have subsidised fossil fuel energy production in an effort to keep energy prices under control. Elsewhere, the Chinese government approved the construction of an additional 106 gigawatts of coal power capacity in 2022[21]. While in the US, the Inflation Reduction Act has set aside nearly $400 billion of federal funding for clean energy projects[22].

When we consider the likes of a carbon tax, a uniform approach across the world will be essential. For example, implementing a European carbon price without equivalent action elsewhere will simply make Europe less price-competitive, potentially forcing businesses elsewhere with no net reduction in global emissions.

THE IMPORTANCE OF LONG TERMISM

As with wider climate action, the transition from fossil fuels towards a clean energy economy is a long-term phenomenon. It will require sustained, coordinated efforts over the coming decades. This exposes it to another risk - that of short-termism.

Governments, in particular, must weigh up their long-term climate ambitions with short-term priorities, such controlling the cost of living. We must consider whether politicians will be willing to enact policies which drive higher inflation, if these could affect their popularity with the public. A public backlash could prevent climate policies being implemented before they bear fruit, potentially leading to backtracking or even a change of administration.

Of course, there may also be drastic attitude shifts from one administration to the following, as we witnessed in the US with the exit and re-joining of the Paris Agreement. If there is a change in the White House after 2024's election, what could this mean for the country's climate ambitions?

[21] *'China permits two new coal power plants per week in 2022', Centre for Research on Energy and Clean Air, accessed April 2023.*
[22] *'The Inflation Reduction Act: Here's what's in it', McKinsey & Company, accessed April 2023.*

THE IMPACT ON FINANCIAL MARKETS

The climate transition, and any related effects on growth and inflation, will impact most financial markets, although it is difficult to make confident assumptions over the long-term. Research from the United Nations Principles for Responsible Investment suggests that we will see the greatest variations within asset classes, rather than between them. We can also expect higher risk premia, owing to greater macroeconomic and market volatility from the transition.

However, we are able to make assumptions about a number of sectors and regions, based on the clean technology investment we expect to see over the coming years. For example, metal intensity is higher for electric vehicles than internal combustion engine vehicles, while wind power farms require more metal than natural gas plants. This increased demand for these clean technologies should therefore have a greater impact on commodity-related emerging markets. For example, according to Bloomberg data, the metals and mining industry comprises only 1.86% of global market cap, but comprises 18.2% of the Brazilian equity market, 11.5% of Mexico and 15.2% of Peru.

CONCLUSIONS

It is clear that the significant transition from fossil fuels to a clean energy economy will have a material impact on both economic growth and higher inflation over the coming decade. The risks of short-termism and a disorderly transition also stand to exacerbate these effects. Ultimately, the impact will depend largely on the scale, speed, and orderliness of the transition. However, in order to achieve the goal of combating climate change, we must accept these macroeconomic consequences, and the associated ramifications for political and public discourse.

MEMBERS

This document is the result of the work carried out by the Working Group members. It also reflects the contributions made by the Oxford/23 Congress participants during the congress' deliberations and in the review phase afterwards.

Working Group Leaders

- **Ignacio Rodriguez Añino**, Responsible for the Commercial Development of M&G Investments in Spain and Latin America.

Technical coordinator

- **Ana Rivero Fernández**, Global Technical Coordinator of the Global ESG Think-Tank - GET-2.

Members

- **Álvaro Carbón Ripepi**, Executive Director of GAM Investments.
- **Juan Ramón Caridad**, Member of Fide´s Board. Managing Director at GAM Investments.
- **Pilar Galán Gavilá**, Partner Head of Financial Services Legal at KPMG Spain.
- **Eduardo García Hidalgo**, Global Chief Investment Officer at BBVA Asset Management.
- **Sara Margarita Hernández Hernández**, Project Leader in the General Directorate of Financial Risk Management at CONSAR.
- **Philip Kemp**, Investment Writer at M&G Investments.
- **Philippe Le Gall**, Senior ESG Engagement Specialist at Pictet Asset Management.
- **Jaime Martínez Gómez**, Global Head of Asset Allocation. BBVA Asset Management.

This report is signed in a personal capacity and does not represent the official position of the institutions or entities to which the members of the group belong.

GET²
Global ESG Think-Tank
Finance and Law Engaging our Society

FINAL REPORT

Oxford/23: Overcoming the main ESG investing challenges

ESG elephants in the room: Indicators for Sovereigns in emerging markets & Social Bonds

Working Group 4 Report

WG 4 Report:

ESG elephants in the room: Indicators for Sovereigns in emerging markets & Social Bonds

ABSTRACT

The specific use of proceeds bond market has mushroomed over the last 5 years enabling the allocation of capital to predefined social and green projects.

As the world orientates itself towards financing which fulfils social and or green objectives will this market continue to expand and how should sovereign and emerging market issuers consider the issuance of specific use of proceeds bonds?

In particular, what can we improve to facilitate sovereign social bond issuance and what should we avoid?

Keywords: *ICMA Social Bond Principles, ICMA Green Bond Principles, Sustainability Bond Guidelines, Clean Energy, Climate change, Renewables.*

Final Report
Overcoming the main ESG investing challenges

WHAT ARE SPECIFIC USE OF PROCEEDS BONDS?

Green, social and sustainability bonds are "specific use-of-proceeds" bonds, which means the financing is exclusively channelled to pre-identified projects where the outcome will be green, social or sustainable. Until recently, this was a much-undernourished area of issuance, but in the past 6 years there has been an orientation towards financing which targets specific social and sustainable outcomes.

One of the main drivers of this, alongside increased investor demand, has been the launch of codes of best practice: the International Capital Markets Association's (ICMA) Green Bond Principles, a voluntary framework for good practice around guidelines, transparency and disclosure, were announced in 2014 with a revised version arriving in June of this year, while the Social Bond Principles and Sustainable Bond Guidelines followed in 2017.

WHY ISSUE SPECIFIC USE OF PROCEEDS BONDS?

- Society is increasingly more focused on investments which can generate positive social and or environmental outcomes.
- Greater focus on climate issues through net zero targets, SDG targets.
- COVID- 19 catalysed the issuance of social bonds with over $200 billion of social debt issued within 6 months on pandemic alleviation solutions.
- Post covid we have seen a greater awareness of financing which targets social outcomes particularly around:
- Rising inequalities – Asia Development Bank Gender Bond
- Vaccination solutions - IFFIm
- Geopolitical risk and the support of refugees - Council of Europe Social Inclusion Bond

Given these bonds are actively providing solutions to social and environmental challenges, they can be characterised as impact generating investments using the European Sustainable Investment Forum's (Eurosif) classification of sustainable investments, i.e. the investments provide both a financial return and impact. The bonds focus on positive investor impact through the allocation of capital to pre identified social and environmental projects and the impact is measured and reported to investors at least annually.

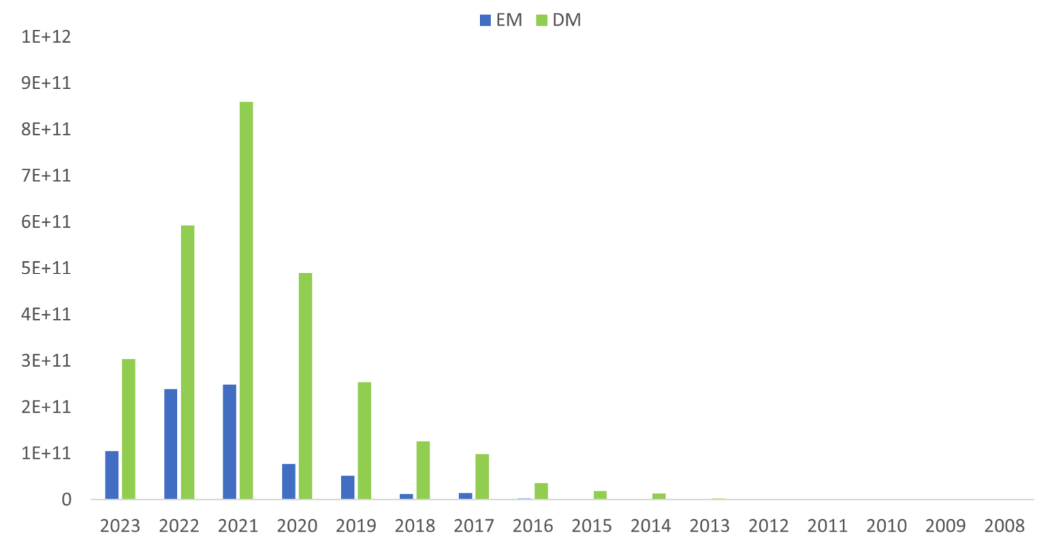
DEVELOPMENT OF GREEN, SOCIAL & SUSTAINABILITY BONDS

Figure 2 – Development of Green, Social & Sustainability Bonds

Source: Columbia Threadneedle Investments

DEVELOPED MARKET VS. EMERGING MARKET ISSUANCE

Figure 3 – Developed Market vs. Emerging Market Issuance



Source: Columbia Threadneedle Investments

GROWING THE MARKET

Despite the strong growth of social in recent years, green bonds still dominate the market, so how do we develop social bond nexus?

1. Engagement is crucial

We believe it is important to engage with issuers on social and in some cases educate them as the focus traditionally has been on the environment. We believe the environment and social should not be treated exclusively but as one. Social investing is all about people and ultimately protecting the planet and funding a transition is for the preservation of society.

2. Embed social characteristics into Green Bond frameworks

Even if social bonds are not issued, we want to see Green Bonds with social co benefits. An example of this, is the UK Green Gilt which is allocating capital for Green Infrastructure and within that framework is ensuring job creation for all new projects.

Similarly, Green Bonds that target the just transition should be encouraged and a point of engagement with issuers. The just transition relates to the shift to a decarbonised future without a reduction in jobs and not funded by the most vulnerable areas of society.

WHAT IS THE OPPORTUNITY FOR SOVEREIGNS?

- Sovereigns have a great opportunity to allocate capital particularly to socially positive projects. Arguably in emerging markets the opportunity is far greater and is more tangible to investors. However, very little issuance has been established and the majority of social issuance to date is from corporates and supranationals.
- Chile and Equator have issued social bonds both issuing capital to support domestic social housing and provides a salient example of how other countries can issue specific use of proceeds bonds.
- Beyond social housing creation, significant investment is required across:
  - healthcare,
  - gender inclusion,
  - infrastructure
  - access to services
  - jobs and education

WHAT TO IMPROVE AND WHAT TO AVOID? – QUESTIONS TO BE DISCUSSED

1. Regulation

A significant headwind in emerging markets is that of accountability and regulation in terms of the guarantee of the funding and ensuring the capital should flow to the predetermined projects. This headwind can be alleviated through issuing ICMA labelled social bonds. As previously discussed, an ICMA Social Bond will provide the transparency and accountability required because the issuer is obliged to create a Social Bond Framework highlighting potential use of proceeds and then report to investors on an annual basis where the capital has been allocated. This should ensure the funding is appropriately identified and capital is allocated according to the framework regardless of the political environment, i.e. in countries where government turnover is high a question could be raised around the commitment to fulfilling the financing of a social bond from a previous government regime.

Furthermore, whilst the EU has seen guides of best practice primarily with an EU Green taxonomy and drafts of a social version. Similar practices have not been employed in emerging markets and could be a helpful tool to underscore the benefits of regulation and education are in the development of this market.

2. Reporting

Reporting is clearly a key aspect of the Social Bond proposition and in terms of advancing development in this area further we would like to see greater focus on evidence of impact across the metrics. For example, listing key social and environmental metrics in relation to the impact generated is essential however we want to see more. We propose reporting should include metrics relating to surveying of the target population in order to assess how beneficial the projects have been. Few issuers do this today however Caixa Bank's social bond impact report is an exception and in our opinion the best in class of what all impact reports should aspire to.

3. Gender Bonds

In 2019, prior to the COVID-19 crisis, the World Bank (2021) estimated global gross domestic product (GDP) to equal almost USD 88 trillion. McKinsey (2015), in its report The Power of Parity, calculated that a scenario whereby women participated in the global economy identically to men could increase annual global GDP by $28 trillion. There has been very little activity in this area and Sovereigns, in particular EM Sovereigns could provide capital for gender focused SME investment.

4. Case Study: Asia Development Bank

Asia Development Bank (ADB) issued a Social Inclusion gender Bond (ICMA compliant) which issued a series of gender bonds in 2022.

Through its Gender Thematic Bond program, ADB has raised over USD $2.9 billion. These bonds focus on programs, projects, investments and loans in gender equality and women's empowerment. The goal is to mainstream gender equality, develop gender targets across employment, increase economic participation, improve social protection and health programs, as well as support prevention of and response to gender-based violence. ADB programs recognise the vulnerability of women in climate shocks, as well as the important role of women in climate adaptation and in resilience strategies that deal with disaster and climate-related shocks and stresses.

5. The rise of sustainability linked bonds

- Sustainability linked bonds are still originating some controversy in the market for the different approach they are taking versus use of proceeds bonds. Their main critic is still the level of ambition of the KPIs selected by issuers of these type of bonds. The lack of ambition has made part of the investor community to think that these bonds do not essentially provide any additionality or impact and are typically targeting KPIs under a business-as-usual scenario. They said to consider this as the most concerning area within the bond market in terms of green washing with the risk being that issuers jettison their social and green bond frameworks in favour of a sustainability linked bond and therefore dilution of this area of the market.

- The main driver is the level of difficulty: These are GCP bonds with KPIs and if the issuer fails the investor receives a step up in the coupon.

- Uruguay issued an SLB earlier this year but how challenging are the KPIs and actually their structure is if they meet the targets, they pay a lower coupon.

- Risk is not only with the issuer but also the second party opinion.

- Very little evidence of any issuers missing their targets and would be a positive sign for the development of this market to see companies missing targets as it provides a better signal on the target being stretching, well calibrated, and ultimately - despite the miss - that company could have produced a better ESG outcome than if it had achieved a non-stretching target.

- Misses can provide data points around the resulting impact on bond price, liquidity and investor behaviour which should prove useful as the market develops.

Additionality

The central objective behind social bond issuance, indeed any specific use of proceeds issuance is the creation of impact, i.e. using the bond market to fund initiatives which create positive environmental and/or social outcomes. Ideally, this would be new projects: new schools, new hospitals, new bridges, new jobs. It could be argued that existing general corporate purpose bonds can also be employed to create new projects however there is no transparency involved in these bonds and as such the proceeds can be tracked and therefore hard to illustrate the additionality. With Social Bonds use of proceeds are salient and as such investors can ensure that the capital funding new projects does happen, and impact is created.

For example, with the UK Green Gilt, the use of proceeds is focused on green infrastructure and social co benefits through the creation of Green jobs. With a general UK Gilt there would have been no obligation to fund exclusively green infrastructure and no commitment to fund Green jobs so highly unlikely these would have occurred without the Green Bond.

PROPOSALS AND CONCLUSIONS

Social bond issuance can continue to grow in absolute volumes but also in breadth and emerging market sovereigns could provide a great opportunity for socially focused capital from the public markets. Until now issuance has been low but that masks the willingness to consider social issues.

In order to develop the market, a combination of education, oversight and accountability are the necessary ingredients and for sovereigns to benefit from the best practices of corporates, development banks and sovereigns who are existing issuers in this space.

MEMBERS

This document is the result of the work carried out by the Working Group members. It also reflects the contributions made by the Oxford/23 Congress participants during the congress' deliberations and in the review phase afterwards.

Working Group Leaders

- **Benjamin Kelly**, Director of ESG & Impact Columbia Threadneedle Investments.

Technical coordinator

- **Ana Rivero Fernández**, Global Technical Coordinator of the Global ESG Think-Tank - GET-2.

Members

- **Pablo Alonso Montes**, Senior Manager in KPMG.
- **Eduardo Antón**, Vice President - Product Solutions - Wealth Management. Itaú Unibanco IEB.
- **Elena Carranza**, Marketing Manager Iberia, Columbia Threadneedle.
- **Raúl Alfonso Espinoza Estrada**, Head of strategy investments at Operadora de Pensiones Complementarias de la CCSS.
- **Eduardo García Hidalgo**, Global Chief Investment Officer at BBVA Asset Management.
- **Javier Glejberman**, Head of Economic Studies, República AFAP.
- **Cecilia Gómez**, Economic Research Analyst at AMAFORE.
- **Andrea González González**, Deputy Director General at SpainSIF.
- **Asunción González**, Head of Economic Studies at AMAFORE.
- **Ana Guardia**, Head of Capital Markets, ICO
- **Nagore Llorente de Pablo**, Senior Capital Markets Officer, ICO
- **Roberto Mendoza**, Investment and Risk Director at AMAFORE.
- **Gizelle Rivera Contreras**, Deputy Director of Financial Research at the Financial Vice-Presidency of CONSAR.

This report is signed in a personal capacity and does not represent the official position of the institutions or entities to which the members of the group belong.

GET2
Global ESG Think-Tank
Finance and Law Engaging our Society

FINAL REPORT

Oxford/23: Overcoming the main ESG investing challenges

Challenges for ESG commitment across end-investors

Working Group 5 Report

WG 5 Report:

Challenges for ESG commitment across end-investors

ABSTRACT

The asset management industry plays a crucial role in promoting ESG investing, but the adoption of ESG practices for retail investors (end-investors) has faced significant headwinds.

The objective of the paper is to examine the challenges associated with ESG commitment and engagement across end-investors. It explores, among others, the difficulties in incorporating sustainable investing adoption with pragmatism and based on actual end-investor needs. There are several obstacles for end-investors among which we could highlight: difficult implementation because end-investor profiling process is done without proper metrics and the lack of sustainable products in a world with over 30 different taxonomies; low consistency across data providers and not enough data to provide proper information on a portfolio level; many key asset classes for end-investors are not properly covered by ESG standards; lack of solid financial educational; end-investors feeling lost trying to cope with an “ESG Alphabet Soup” made by a tsunami of new concepts and acronyms; end-investor preferences towards sustainable investing are not consistent due to external factors such as inflation levels, interest rate hikes, geopolitical events or performance trends.

The financial sector uncertainty could trigger a defensive attitude postponing innovation or active marketing with end-investors. It seems that their needs are neither at the core nor at the wheel driving this process, bringing confusion and disinformation. This happens while more voices are asking to simplify end-investors onboarding process to understand their ESG preferences and knowledge (the current process restricts the implementation details and the engagement of invested companies).

We need to contribute to save the planet without driving crazy end investors and/or jeopardizing the investment manager’s credibility due to the lack of tools to implement sustainable investing across all client’s portfolios. We all need to be united to make this happen. The buy and the sell side, public and private institutions and/or local and supranational regulators are more than ever in the same boat regarding the net zero transition. Contributions, cooperation, and brainpower from all of them are critical factors and are more than welcome.

Keywords: *ESG commitment, engagement, awareness, landscape, drivers. ESG jargon. Investment Standards, Metrics and Regulations. Risks and Opportunities. End-Investors’ concerns. Cost implications. Data quality and availability. ESG investment trade-offs. ESG Performance. Market cycle and volatility impacting ESG. ESG Regulation. Financial education. False advertisement. Greenwashing. Accounting and ESG reporting rules homogenization. Constant ESG changes. Green MIFID. Incentives. Scope 3. ESG and KYC. Greenwashing. ESG mapping. Rating Methodologies. ESG adoption catalysts.*

HIGHLIGHTS

End-investors are challenged from a regulatory and educational angle

Imagine an end-end-investor working from Madrid, Miami, and Mexico (or Barcelona, London, and New York) trying to decide which taxonomy to follow around the globe and trying to match SFDR (products) with MiFID (services) regulations to build portfolios. Regulation says meeting with the end-investors should be driven with accuracy, simplicity, and transparency. Concepts such as EETs or PAI, current ESG ratings or differences between ethical, socially responsible, sustainable funds, are creating end-investors confusion. It is common to hear comments such as: “I’m not sure about what is sustainable or not” (in addition to the clear unsustainable fact of losing more than 10% in short term fixed income funds on top of paying VAT taxes for the sustainable advisory given). In conclusion, end-investors are overwhelmed and confused by the number of acronyms, sustainable jargon and institutions involved in something which was not even requested by them.

- **Inconsistent ESG Standards, Lack of Proper Metrics and Dozens of Different Taxonomies Worldwide**. There is a lack of data in the next 3-4 years, in addition to several and meaningful uncertainties around the quality of that quantitative information. Global players must cope with local heterogeneous implementations. A global player with an end-investor operating in Mexico City, Miami and Madrid would deal with 3 different ESG approaches.

- **ESG Jargon Complexity, also known as “the (ESG) Alphabet Soup” for end-investors.** Many new concepts, tons of acronyms and hundreds of institutions mentioned when talking about ESG. The growth is exponential. Any nuance has a proprietary word and end-investors are confused and lost with the meaning of so many. They need a map and a simple tool to follow the concepts and they receive just the opposite. There is a lack of understanding and awareness by end-investors and, also on many occasions, by intermediaries.

- **Mixing sustainability and Performance is Confusing and Triggers certain Risks** (while sending the wrong message). Sustainable investing is not a guarantee of better performance in the short term. A preference or any factor risk bias will generally mean a higher tracking error. Due to last market corrections (i.e., significant increase in oil and gas prices following the war in Ukraine), end-investors are disappointed with ESG product performance. They are not fully aware of the ESG associated risks in terms of spread duration, sector, or factor risk biases.

- **End-investors need simpler communication to be able to make their decisions, while Institutions should consider being more directive in those the decisions**. Institutions need to consider end-investor objectives and priorities, while they incorporate these in an easy and clear way, so the decision process is simplified. An end-investor buying an EV car does not ask for more technical details other than the Eco-label; regulatory pressures, accountability and engagement is performed on a B2B basis. This also requires a deeper level of knowledge and understanding from the institutional and independent advisors to end-investors and an appropriate level of disclosure, beyond the EET, to navigate the range of products.

End-investors Profiling & Data challenges

End-investor allocations to Sovereign Debt, FX, Commodities, Hedges or Insurance Linked Securities are too big to be marginally covered by Sustainable Investing Standards compared with asset classes such as Corporates or Equities. Some common characteristics of ESG Data is that is full of estimations, is rarely audited, is often reliant on 'blackbox' methodologies that differ among institutions and is expensive. Additionally, we find that the correlation between ESG ratings is low (below 0,3 in many cases), fully heterogeneous and does not allow to provide information on an end-investor portfolio level (even if the portfolio only invests in "pure ESG products" such as Green Bonds. End-investor preferences are not linear neither static. A war like the one in Ukraine, opportunity cost by interest rates, recessions and unemployment levels, energy, core inflation or weather temperatures could trigger significant changes in end-investor preferences.

- **Limited Data Availability, Quality and Oligopolistic Risk**. Most companies do not report their full ESG data, and the ones reporting it, use their own criteria and system, while at the same time financial institutions use different ESG data and criteria to analyze the same companies and compare products. On many occasions, institutions extrapolate data and make judgement analysis without all the information just because they need to fill the "empty spaces" and because they are encouraged to do so from SFDR periodic reporting requirements. And this happens for more accessible asset classes because data for too many other asset classes (i.e., sovereign debt, social bonds) is even weaker and harder to find. On a related note, we also find that EET data clearly does not include the right metrics to aggregate PAIs portfolio preferences. So not only we don't have the right data, we also don't have the right processes or templates to get that data together and be able analyze it to compare apples to apples.

- **Active Ownership and Engagement**. ESG is very interlinked with the political agenda and creates sides (in favor or against). Each political cycle has its own view about how to address ESG inclusion in the day to day for end-investors and what type of support to give to promote ESG implementation. Polarization is a roadblock for a common goal. Society (end-investor) needs consensus and continuation in time, regardless of which political party is governing. The only political influence should be to support and give impulse to ESG implementation, and even this should be done in a non-political way from a neutral institution or entity

- **Short Term Biased End-investor Preferences**: the interests of the different stakeholders are neither aligned nor shared. Financial institutions have more medium-long term ESG views and actions are biased to avoid legal risks. End-investors tend to have shorter time views and be performance biased.

- **Limited Availability of ESG Investment Information and Products**. It's true that ESG products have increased exponentially in the last years, but they still need to cover many more products across all asset classes.

- **Market Volatility & Opportunity Costs**: when there is a market volatility increase from causes such as higher inflation or significant rates hikes, end-investors could be less loyal to ESG products or ESG preference. ESG conviction in end-investors is second to performance and it is easily sacrificed as soon as volatility affects returns. ESG in investments needs of more end-investors knowledge, commitment, and long-term periods if we want to have a sustainable and irreversible implementation.

- **Lack of proper and easy to understand ESG profiling during the KYC process.** Many factors make the process less effective. Among these we can mention factors such as changes in ESG preferences to match product availability, lack of knowledge and/or confusion from end-investor's translating into these delegating to institutions the selection of ESG preferences, questions being asked in a way that influences or drive certain answers, lack of unified industry approach makes each institution creating its own profiling process or having guided profiling.

- **Cost Implications**. ESG requires additional costs in a market driving for lower management fees. There is a risk that the increased cost of ESG data, analysis and engagement makes these products inherently less attractive that 'non-ESG' products.

Marketing uncertainties forward implications of today's innovation in a working environment with poor data and lack of factual homogeneous metrics.

The stricter you are as a ManCo or Distributor in the sustainability definitions, the less inflows you get. As more innovative and proactive you are today, as higher it would be tomorrow's risk of potential greenwashing under forward interpretations of past initiatives. For example, funds that were launched before the most recent Regulatory interpretations and definitions e.g. on sustainable investment, are clarified. Regulation is being applied retrospectively without clarity on the current expectations or a clear timeline for implementation

- **Impact Highlights could be considered as Greenwashing**. Marketing is full of metrics (sometimes in absolute terms, sometimes in relative terms and some others just hypothetical proxies) that are not consistent across different products nor able to be grouped on a portfolio level.

- Many regulations as well as a lack of tools and data to be adopted, not only within the financial industry, took many years to be developed and, most importantly, adapted. **It seems like ESG has been rushed** and the speed itself generates several complications along the whole adoption process.

HIGHER PRIORITIES, WORKING GUIDELINES AND SOLUTIONS PROVIDED

1. Mapping: Taxonomies and Sustainable Accounting Standards

- Over 30 different taxonomies worldwide. Mapping the different taxonomies is one of the main needs required to end-investor at a global level.
- Art 2.17 that describe sustainable investments is too generic and not enough to be able to consolidate ESG information on an end-investor portfolio level. Impact-Weighted Accounts Project at Harvard University is one of the most inspirational working avenues to address this problem. Mandatory accounting metrics are so important. At least one single homogeneous metric for E and S would simplify the situation to consolidate info on a portfolio level.

Fully integrated and mapped frameworks among SASB (Sustainability Accounting Standards Board), GRI (Global Reporting Initiative) and TCFD is critical to achieve a proper level of consistency. Mapping, adding, or merging these accounting standards is the path forward. We want to recommend that all jurisdictions make Reporting against ISSB mandatory. A linked challenge is that we have very different Reporting requirements across jurisdictions. This can lead to a much higher Reporting 'burden' for European companies but also a much more limited 'investible universe' for sustainable products. For example, the requirements for 'good governance' or 'do no significant harm' are much more challenging in EM vs DM / and in sovereign vs corporates, but this is ultimately where much of the capital needs to be allocated to address the global Sustainability challenges.

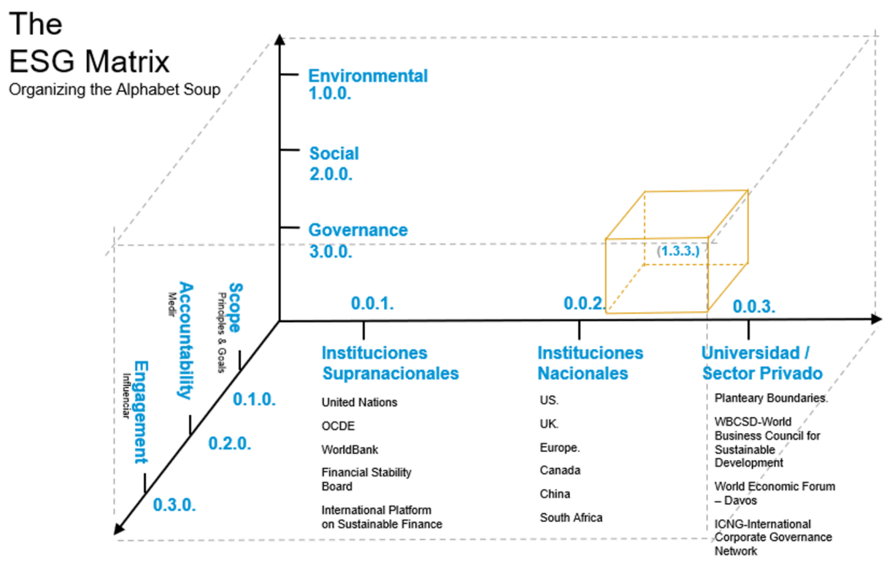
2. Financial Education

To ask an end-investor to select concepts such as taxonomy or PAIs without using technical language seems contradictory. Even when sector professionals may have ESG certifications, it's not a give to expect teaching skills translating the technical concepts to end-investors in a clear and simple way. To be a good driver is not always a synonym of passing the driving exam neither a guarantee to be a good driving teacher. Beyond making sure professionals have a minimum ESG knowledge and maintain this on an on-going basis as the market and concepts continue to develop, it's also needed to educate them on how to explain technical concepts to end-investors. At the same time, end-investors need a significant effort to be willing to learn ESG concepts. There is not a good teacher until the student is ready for it.

3. Coping with the ESG Alphabet Soup

- **The ESG Matrix:** The idea is quite simple. To group by the sustainable concepts, acronyms and institutions involved in a 3X3 block. Each refence will have a clear code to help many professionals and end-investor to locate the sustainable universe. An illustrative example: SDGs (Social Development Goals) would be 123.1.1 because they cover environmental, social and governance, are presented by OCDE (Supranational Institutions) and are clearly principals or goals. NDCs (National Climate Plan, NDC Targets) would be 1.2.2 or the Net Zero Alliance would be at the 1.3.3. box (illustrated in yellow) .

Figure 1 - The ESG Matrix



Source: BME Institute, MFIA Master

- It is needed an ESG Wikipedia in 3 levels to fulfil the definition needs:
  - Level 1: Concept. One liner explanation and/or and educational animations or drawing cartoons.
  - Level 2: Short technical definition.
  - Level 3: Extended sophisticated and accurate definition.

In the meantime, this working group was writing this document we were glad to realize that Financial Times is fully agree with this goal. FT: "Climate change A to Z: an FT jargon buster"[23].

[23] https://www.ft.com/content/c617f52a-b46a-4581-8b66-8d92f672f77c

4. Simplify to end-investors getting full access to information upon request. Implement a claw back solution towards product providers and not per product per end-investor

Does it make sense to have a 5-stars room in a 1-star hotel? Common sense would say no and the same rational should apply to a SFDR art 9 ESG product from a Management Company not committed on a corporate level with sustainable principles. In hotels from 1 to 5 stars, in restaurants from 1 to 3 stars, in supermarkets with food ratings from A to E or when people buy a car with environmental tags (B, C, ECO, Zero), they all follow the same recipe: regulation, audit process and implementation are all performed on an entity level. There should be clear minimum standards that align management and implementation of products to be fully transparent with end-investors, and that institutions should also have a ESG rating accessible to end-investors.

This approach would avoid unnecessary end-investor noise and variable technical specifications that require levels of expertise and education out of average end-investors scope. Criteria definition per products would be discussed between Management Companies and Regulators, reviewed on ongoing basis, and implementing best pragmatic options each year. Accountability and engagement done on a ManCo level and not per product and per end-investor would increase efficiency. Technical information would be available for end-investors upon request, but end-investor would not be forced to go over every single sustainable technicality to select a product.

At the end of the process, end-investors should be allowed to combine financial products and services, both ESG and non-ESG. All financial instruments should be included in the sustainable rating. It's not just a mutual fund discussion. All investment instruments should be under the same scope, independently of whether they are structured products, synthetic products, deposits, FX, Unit Links, Pension Funds, Insurance Linked Securities or any other asset and liability matching program.

5. 3D: Performance, Risk and Sustainability

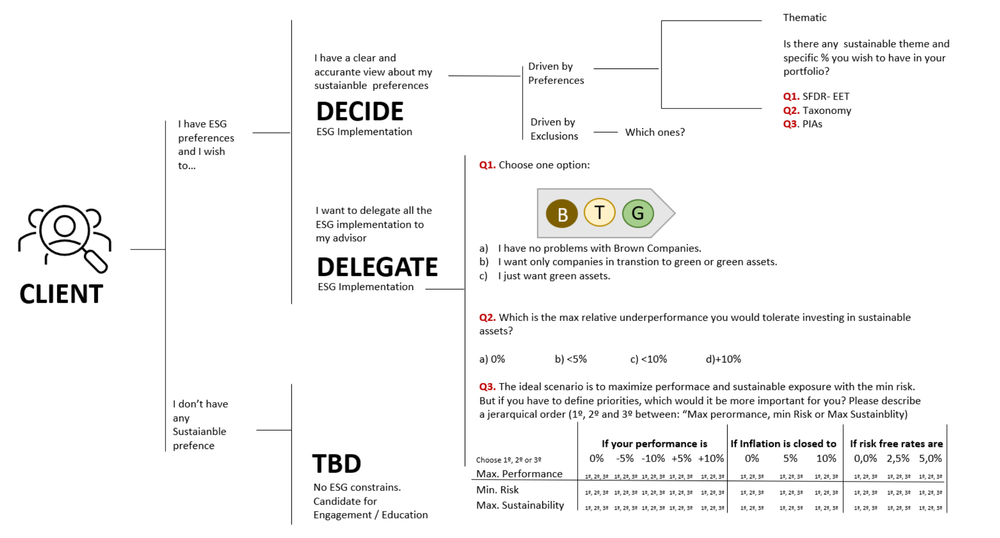
Portfolio construction for sustainable investors will always try to maximize and optimize the 3 dimensions (risk, reward and impact) but it would be highly recommended to reinforce the message the independency between the performance and sustainable investing in the short-medium term. Pure sustainable investing represents a preference, an investment bias, and a source of tracking error vs traditional benchmarks. To contribute to a better environment, to have a strong social commitment and to show the highest levels of corporate governance, are all great contributors to achieve better results and more sustainability in the long run but the short-medium horizon is driven by a width range of factors including liquidity, market sentiment, behavioral finance and central bank policies.

6. Improvements required regarding data and end-investor profiling

An agreement should be reached among the industry participants regarding common mandatory metrics (and how to group them) for E, S and G (specially on S where there is not enough data). All actions taken should pursue the standardization and transparency of information and processes giving a balanced weight and important to all 3 letters. It's not just about E. S matters and G should be a given.

Distributors serving end-investors daily request for a simplification of sustainable end-investor profiling. Many end-investors have no clear sustainable preferences, they just have lightweight biases with no accurate demands. In many cases, end-end-investors hardly express some exclusions and there is a strong tendency to delegate the sustainable preferences to the advisor. There is room between a high conviction ESG demands or nothing. Many end-investors demand a simplification of the sustainable profile and to delegate the ESG implementation to the distributor. They want to buy sustainable funds in a similar way as they buy sustainable goods (cars, food, etc.), meaning, choosing a label, discussing about relative performance vs non sustainable options, and selecting ranked preferences (1st, 2nd or 3rd). It would be a potential solution to include Behavioral Finance scenarios (higher inflation, performance drawdowns or higher interest rates) in the proposed ESG questionnaire.

Figure 2 - ESG questionnaire for end-investor profiling



From the diagram above: **Questions and options to ask clients who want to delegate the ESG implementation**

1. Please choose an option regarding the type of companies you want to invest in, either Brown companies, companies in transition to green or green assets, or just companies with green assets.

2. Please select the maximum relative underperformance you would tolerate investing in sustainable assets.

3. If you had to define priorities, which would it be more important to you among max performance, min risk and max sustainability.

At the same time, clear rules on what can't be done with the data, i.e., extrapolation or estimation, should be specified and audit works should be implemented.

Mandatory ESG end-investor profiling requires a wide range of products for any of the potential answers given by the end-investor. Otherwise, end-investor profiling would be biased.

End-investors willing to delegate sustainable specific preferences, looking for a generic preference or a basic priority should be allowed to choose. It should not be a black and white decision. And of course, Investment Managers should disclose the % of total exposure to sustainable assets implemented in the client portfolio.

7. Marketing and End-investor Information

There should be a focus on making clearer, simpler, and more generic questions for end-investors to increase their understanding and getting their consent. The system cannot rely solely, among others, on end-investors financial education nor more supervision, access to information or regulation.

Simplicity comes first at this stage. It is not a matter of oversimplifying, but it is critical to get end customers on board since the beginning. If we help them understand "logarithms" rather than "additions and subtractions", customers will feel far away from the final objective: get them on board. Is time for bay steps. There is a defined way to make things in an orderly manner: we need customers to transit from awareness, to interest, understanding, receive incentives then and finally act.

End-investors would benefit from an office, supervised by the regulator, where they could consult about ESG regulations, industry changes, concepts, products and services, false publicity (Greenwashing), and any other relevant information that affects them and that involves ESG concepts. In addition, this should be aligned and integrated with non-ESG information, so there is no confusion nor different information sources. Active promotion and accountability from all stakeholders would benefit the information centralization in one single place. This office should be controlled and supervised at a regional level by EU regulators, so there are common standards and rules for all countries, and these standards should be enforced across all countries following the same approach.

8. Tax neutrality for ESG Advisory Services & Products vs Other Investment Services & Products

If an end-investor is asked if he/she wants to pay more taxes, the more common answer would is "no", implying that they prefer RTO services. These services do not require neither end-investor profiling (KYC) nor advisory services, both of which increments end-investor costs. The creation of ESG products usually implies higher (direct or indirect) costs for end-investors. ESG services and products would benefit if they would have tax advantages that would equal them to other investment services & products, at least to be able to not be discriminated due to incremental costs.

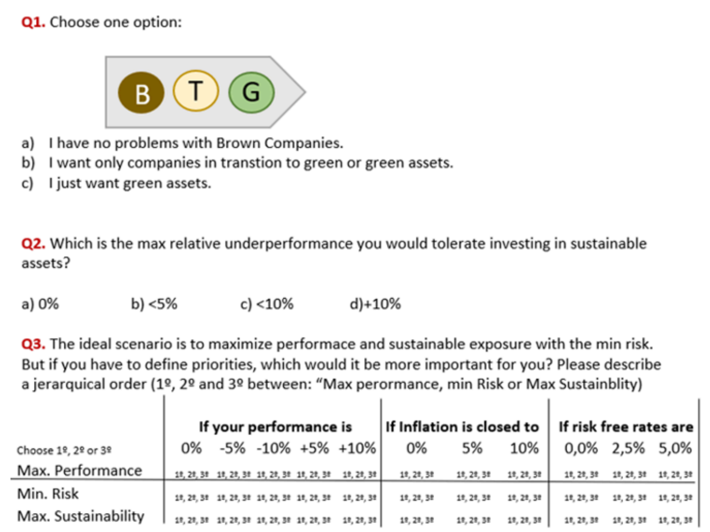
CONCLUSIONS

It's key to listen to end clients. They are the end asset owners and sustainable investing demand can't be successful without listening to them. Surveys of end-clients and across the professionals dealing with them would be highly recommendable.

Fully integrated and mapped frameworks and standards from SASB (Sustainability Accounting Standards Board), GRI (Global Reporting Initiative) and TCFD are critical to achieve a proper level of consistency. Mapping, adding, or merging these accounting standards is the path forward. We want to recommend that all jurisdictions make reporting against ISSB mandatory.

All financial instruments should be included in the sustainable rating. It's not just a mutual fund discussion on corporate bonds or equities. All investment instruments should be under the same scope, independently of whether they are structured products, synthetic products, deposits, FX, Unit Links, Pension Funds, Insurance Linked Securities or any other asset and liability matching program. End-client portfolios are mainly invested into public debt and not to corporates.

Many end-investors have no clear sustainable preferences, they just have lightweight biases with no accurate demands. In many cases, end-end-investors hardly express some exclusions and there is a strong tendency to delegate the sustainable preferences to the advisor. There is room between high conviction ESG demands or nothing. It's not about black and white. Many end-investors demand a simplification of the sustainable profile and to delegate the ESG implementation to the distributor answering 3 simple questions (see chart below) to define exclusions, tracking error tolerance and sustainable priorities changes in different scenarios. They want to get some exposure to sustainable assets in a similar way as they buy sustainable goods (cars, food, etc.), meaning, (1) choosing a label, (2) disclosing max tolerance to relative performance vs non sustainable options, and (3) selecting ranked preferences (1st, 2nd, or 3rd) between maximizing performance, risk or sustainability in 3 scenarios (higher inflation, performance drawdowns or higher interest rates).


Q1. Choose one option:

B T G

a) I have no problems with Brown Companies.
b) I want only companies in transtion to green or green assets.
c) I just want green assets.

Q2. Which is the max relative underperformance you would tolerate investing in sustainable assets?

a) 0% b) <5% c) <10% d)+10%

Q3. The ideal scenario is to maximize performace and sustainable exposure with the min risk. But if you have to define priorities, which would it be more important for you? Please describe a jerarquical order (1º, 2º and 3º between: "Max perormance, min Risk or Max Sustainblity)

	If your performance is					If Inflation is closed to			If risk free rates are		
Choose 1º, 2º or 3º	0%	-5%	-10%	+5%	+10%	0%	5%	10%	0,0%	2,5%	5,0%
Max. Performance	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º
Min. Risk	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º
Max. Sustainability	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º	1º, 2º, 3º

Figure 3– Simple questions about exclusions, tracking errors and preferences in 3 key scenarios.

The industry needs to launch an equivalent to an ESG Wikipedia to **describe ESG terminology in 3 levels**: (L1) Concept. One liner explanation and/or and educational animations or drawing cartoons. (L2) Short technical definition for advisors and distributors. (L3) Extended sophisticated and accurate definition.

We should **group by sustainable concepts**, acronyms and institutions involved in a **3X3 block as described in the Sustainable ESG Matrix with the proper codes** to help end investor to have a latitude and longitude coordinates to map the sustainable universe.

It does not make sense to book a 5-stars room in a 1-star hotel and even more if in the room behind unethical behaviors are taking place. **Is it sensible to be too focused on the product relegating the assessment on the asset manager level?** Investment Managers should get (public) recognition and/or incentivized on a group level for increasing exposure in any investment strategy without losing the fiduciary responsibility to maximize risk-reward goals. At little bit of sustainable exposure in any fund managing the factor risks properly can be more efficient than allocation on specific product ranges and to speed up the next zero transition.

It would be highly recommended to reinforce the message the independence between the performance and sustainable investing in the short-medium term. Pure sustainable investing represents a preference, an investment bias and a source of tracking error vs traditional benchmarks. To contribute to net zero transition, to have a strong social commitment and to show the highest level of corporate governance, are all great contributors to achieve better results and more sustainability in the long run but the short-medium horizon is driven by a width range of factors including liquidity, market sentiment, behavioral finance, and central bank policies.

Quality Data is key for proper client profiling and to avoid misleading implementations. **Clear rules on what can't be done with the data, i.e., extrapolation or estimation, should be specified and audit works should be implemented**. Moreover End-investors would benefit from an office, supervised by the regulator, where they could consult about ESG regulations, industry changes, concepts, products and services, false publicity (Greenwashing), and any other relevant information that affects them and that involves sustainable key concepts.

To increase the cost of being advised in sustainable investing charging Value Added Tax should be reviewed. ESG services and products would benefit if they had tax advantages and or being equivalent to RTO and direct distribution of other financial assets.

MEMBERS

This document is the result of the work carried out by the Working Group members. It also reflects the contributions made by the Oxford/23 Congress participants during the congress' deliberations and in the review phase afterwards.

Working Group Leaders

- **Juan Ramón Caridad**, Managing Director at GAM Investments Iberia, LatAm & USi, Board Member of the Fide Foundation.

Technical coordinator

- **Ana Rivero Fernández**, Global Technical Coordinator of the Global ESG Think-Tank - GET-2.

Members

- **Rita Azahar Hamden Villalobos**, Responsible Consultant at Novaster Mexico.
- **Álvaro Miguel Carbón Ripepi**, Executive Director of GAM Investments.
- **Carlos Diaz Núñez**, Global Hed of Product in Santander Asset Management.
- **Alberto Gómez Reino**, Head of Sustainable Investments at BBVA AM.
- **Andrea González González**, Deputy Director General at SpainSIF.
- **Carlos Garay Gómez-Arroyo**, Responsible for ESG investments at Sabadell Urquijo Gestión.
- **Luis González González**, Head of Sustainability at BBVA Quality Funds.
- **Ana Guzmán Quintana**, Head of Impact Investments at Portocolom AV.
- **Guillermo Hermida,** Head of ESG, La Caixa.
- **Stephanie Maier**, Global Head of Sustainable and Impact Investment, GAM Investments.
- **Gonzalo Meseguer Muñoz**, General Manager at Santalucía AM
- **Belén Vila Martínez**, Fund Analyst in Banco Santander.

This report is signed in a personal capacity and does not represent the official position of the institutions or entities to which the members of the group belong.

GET²
Global ESG Think-Tank
Finance and Law Engaging our Society

FINAL REPORT

Oxford/23: Overcoming the main ESG investing challenges

Digital technologies can help us in the path to green transition and growth

Report:

Digital technologies can help us in the path to green transition and growth

ABSTRACT[24]

Although it can be a controversial topic somehow (due to the high consumption of resources of some digital technologies), it seems to be certain agreement on the fact that digital technologies and the digital transition will help us to accomplish the green transition.

Still, how the green transition is going to be financed remains a question mark. Some studies referenced herein estimate the cost of the green transition in $9.2 trillion per year on average, an annual increase of as much as $3.5 trillion from today.

Banks will play an essential role in the green transition financing. But for so, banks need to be profitable and competitive. Both variables are driven by capital requirements, and to that end, some solutions have been proposed to release capital that could help banks devote enough resources for the green and digital transitions. In addition, other measures to increase banks' competitivity, such as those tending to avoid market fragmentation or to reduce administrative burden can be key for that purpose. Alongside with fiscal policy and incentives and other possible options.

Keywords: *World Economic Forum, Emissions reduction, Green transition, Financing, Private banks, Capital spending, Multilateral development banks, Regulation, Fiscal Policy, Public Sector, Market Fragmentation, Data, Green Technologies, Digital Tecnologies, Digital Talent, Data Transparency*

[24] *Note: please note that This discussion outline represents my personal views and does not in any way represent the official position of the IIF or its membership.*

TECHNOLOGY AND HOW IT CAN HELP COMPLY US MANY OF THE ESG OBJECTIVES

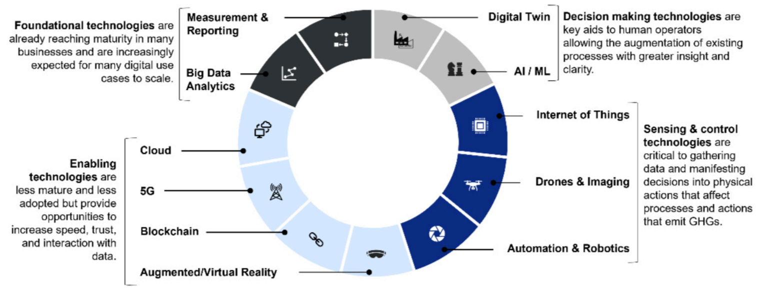
We live with green and digital technologies that allow us to measure many different variables and to analyze and follow them, to visualize and follow objects from the air, to prevent catastrophes (e.g. hydric), to optimize and produce in a more efficient way, with the lesser resources consumption, etc.

There have been some interesting works about how technology can help us comply with the UN Sustainable development goals (e.g. see the International Telecommunication Union (ITU), World Bank and CPMI workstream Financial Inclusion Global Initiative[25] in 2017)

According to the World Economic Forum 2022[26]:

- **New estimates reveal that digital technologies, at scale, can enable up to a 20% reduction by 2050 in the three highest-emitting sectors – energy, mobility, materials.**
- By quickly adopting digital technologies these industries can already reduce emissions by 4%-10%
- Data transparency, digital talent and partnerships are critical for companies to rapidly adopt the technologies and realize their net-zero ambitions faster.

Figure 1 – To deliver decarbonization, 4 clusters of digital technologies can be applied together



Source: Digital for Climate Scenarios, World Economic Forum

[25] *https://www.itu.int/en/mediacentre/Pages/2017-PR36.aspx*
[26] *https://www.weforum.org/press/2022/05/digital-tech-can-reduce-emissions-by-up-to-20-in-high-emitting-industries/*

DOWNSIDES: NOT EVERYTHING IS AS GREENER AS EXPECTED

On the other hand, many authors highlighted how digital technologies are highly resources consuming. Such is the case of a recent article from As Bianchini, S., Damioli, G. & Ghisetti[27], according to which:

- Some technologies are highly energy consuming. And in some cases, they are also highly consumers of raw materials (e.g. certain metals), some of which are scarce of difficult to accede in nature.
- Whilst they also highlight (i) how not all digital technologies have the same impact on the environment, and (ii) that *"Most empirical studies confirm the importance of innovation and technology for emission abatement, supporting the hypothesis that (green) innovations contribute to carbon emission reduction."*

GREEN AND DIGITAL TRANSITIONS IN THE PATH TO GROWTH

Growth is necessary for the citizens´ quality of live to improve[28]. And digital and green transitions[29] need to be pursued simultaneously[30], as they are both essential in the path to growth[31].

According to the IMF[32] "global growth is projected to fall from an estimated 3.5 percent in 2022 to 3.0 percent in both 2023 and 2024. While the forecast for 2023 is modestly higher than predicted in the April 2023 World Economic Outlook (WEO), it remains weak by historical standards." Although predictions vary considerably among regions.

For the green transition to be effective, and to help also increase growth, new technologies and developments need to be financed, so as to help companies to transition from brown to green. But this is not a binary exercise of only financing what is already green. Technologies and innovations need to be put in place for companies to migrate to the green economy. Also, empowering the workforce by better training them and accompanying them in this process. And that, unfortunately, cannot be accomplished in one sole action. It requires a full set of actions, very relevant investments, and going step by step.

---

[27] Bianchini, S., Damioli, G. & Ghisetti, C. The environmental effects of the "twin" green and digital transition in European regions. Environ Resource Econ 84, 877–918 (2023). https://doi.org/10.1007/s10640-022-00741-7 "There is broad agreement that the ongoing digital transformation is changing the environment; however, the direction of this change is the subject of much debate (Sachs 2020). In common with discussions on many emerging technologies, opinion is polarized: its detractors claim "digitalization will destroy the planet"; its proponents counter "digitalization is the solution for environmental sustainability".
[28] IMF - Growth That Reaches Everyone: Facts, Factors, Tools. https://www.imf.org/en/Blogs/Articles/2017/09/20/growth-that-reaches-everyone-facts-factors-tools
[29] Sometimes called, the "twin transitions".
[30] Muench, S., Stoermer, E., Jensen, K., Asikainen, T., Salvi, M. and Scapolo, F., Towards a green and digital future, EUR 31075 EN, Publications Office of the European Union, Luxembourg, 2022, ISBN 978-92-76-52452-6, doi:10.2760/54, JRC129319.
[31] IMF - Toward a Green, Inclusive, and Digital Future. https://www.imf.org/external/pubs/ft/ar/2021/eng/spotlight/toward-a-green-inclusive-digital-future/
[32] https://www.imf.org/en/Publications/WEO/Issues/2023/07/10/world-economic-outlook-update-july-2023

HOW TO FINANCE THE TRANSITION

According to a report by McKinsey[33] "Capital spending on physical assets for energy and land-use systems in the net-zero transition between 2021 and 2050 would amount to about $275 trillion, or $9.2 trillion per year on average, an annual increase of as much as $3.5 trillion from today. To put this increase in comparative terms, the $3.5 trillion is approximately equivalent, in 2020, to half of global corporate profits, one-quarter of total tax revenue, and 7 percent of household spending" plus "Technological innovation could reduce capital costs for net-zero technologies faster than expected."

Are the banks or the public sector prepared to accomplish such a great challenge?

Regarding private banks, another study[34] dated January 2023, from the EBF and Oliver Wyman signaled the path to unlock around 4 trillion of banking financing for the green transition. The study concludes that a review of current capital requirements and supervisory processes could provide capacity for around **EUR 4 trillion** additional bank lending to finance the green and digital transitions and strengthen the competitiveness of the EU economy.

Other measures that might allow private banks increase their competitivity, and thus, their ability to finance the twin transitions, could be those trying to avoid market fragmentation and to eliminate unnecessary burdens for financial entities, etc. Together with other fiscal policy measures and tax incentives, as well as some rigorous analysis on the risks (even systemic risks) of not being flexible enough (e.g., in terms of regulation) as to allow the financial sector to finance both transitions.

The role of multilateral development banks and how they can help unlock resources for the green and digital transitions is also very relevant here.

---

[33] Mckinsey (2022). The net-zero transition: What it would cost, what it could bring. https://www.mckinsey.com/capabilities/sustainability/our-insights/the-net-zero-transition-what-it-would-cost-what-it-could-bring
[34] https://www.ebf.eu/wp-content/uploads/2023/02/The-EU-banking-regulatory-framework-and-its-impact-on-banks-and-theeconomy_30Jan-1.pdf

MEMBERS

This document is the result of the work carried out by members of the GET-2 ESG Think-Tank. It also reflects the contributions made by the Oxford/23 Congress participants during the congress' deliberations and in the review phase afterwards.

Keynote Speaker

- **Gloria Sánchez Soriano**, Senior Advisor of the Digital Finance Department at the Institute of International Finance – IIF.

Technical coordinator

- **Ana Rivero Fernández**, Global Technical Coordinator of the Global ESG Think-Tank - GET-2.

This report is signed in a personal capacity and does not represent the official position of the institutions or entities to which the members of the group belong.

GET²
Global ESG Think-Tank
Finance and Law Engaging our Society

FINAL REPORT

Oxford/23: Overcoming the main ESG investing challenges

Europe and LATAM: Current situation of ESG from a regulatory viewpoint

Report:

Europe and LATAM: Current situation of ESG from a regulatory viewpoint

LATAM-CHILE. CURRENT SITUATION OF ESG

Abstract

Recognizing the relevance of good risk management for Pension Fund investments, over the last decade various complementary approaches to issuer analysis have been developed, from social responsibility to ESG factors, in the context of sustainability and climate change.

The concern of the regulators has not been immune to this discussion, and in many ways has taken charge of this concern, and this is how Mexico, Colombia and Chile have advanced in demanding various requirements for pension fund managers.

Keywords: *ESG, climate risk, investment policies, LATAM, EU, Social responsibility, Pensions, regulation, sustainability*

Chilean case

On July 3, 2019, the Ministry of Finance announced the creation of the Public-Private Roundtable on Green Finance, whose objective was to define an agenda for dialogue and joint work between the government, regulators, and financial market institutions to incorporate risks and opportunities. associated with climate change in decision making. This Agreement defined basic management principles in these matters in line with international standards and advances and was established as the starting point of a long-term agenda.

The dimensions that the work of the Roundtable considered were:

- Risk management
- Green Financial Policies and Instruments

The work of the Roundtable ended with the subscription of various entities, public and private, of commitments associated with their respective fields of action. These institutions were: Ministry of Finance, Central Bank, CMF, SP, Investment Fund Administrators, Mutual Fund Administrators, Pension Fund Administrators, Insurance Companies, Public and Private Banking, and Securities Intermediaries.

To date, the Roundtable is working on the definition of a taxonomy document, and on the review of the initial agreement to identify any eventual need for updating.

Commitments of the Superintendence of Pensions. Implementation and control

- Incorporation of good practice guides in terms of investment processes and risk management, which the boards of the Pension Fund Administrators explicitly consider as relevant financial risks in said processes, climate risk and those associated with ESG factors.
- Incorporation of climate risk and the risks associated with ESG factors within the risk assessment of the Risk-Based Supervision (SBR) process with which the Pension Fund Administrators are supervised.
- Establish that the boards of the Pension Fund Administrators document how they will consider climate and ESG risks.
- Establish that the necessary resources are allocated to generate technical capacities in the teams responsible for such work.
- Establishment in the investment policies of the considerations of climate risks and ASG in the investment and risk management processes.
- Incorporation of particular metrics into investment policies to measure the impact of climate change on the investment decisions of the Pension Funds.

- Delivery of information to affiliates regarding how climate and ASG risks are being considered in investment policies.
- Require that they promote the disclosure of information about how they assess risks related to climate change and ESG in the companies and vehicles in which they invest, and adopt good practices on the matter.

EUROPE. CURRENT SITUATION OF ESG

Sustainable finance refers to the process of taking **environmental, social and governance (ESG) considerations** into account when making investment decisions in the financial sector, leading to more long-term investments in sustainable economic activities and projects.

In the EU's policy context, sustainable finance is understood as finance to support economic growth while reducing pressures on the environment to help reach the climate- and environmental objectives of the European Green Deal, taking into account social and governance aspects.

On 8 March 2018, the European Commission published a **first Sustainable Finance Action Plan** to channel more funding to environmentally sustainable economic activities, particularly towards activities that can play a critical role in reaching a carbon-neutral and climate-resilient economy by 2050. In May 2018 the Commission presented **a package of measures as a follow-up to its action plan** on financing sustainable growth. The package included 3 proposals aimed at establishing a unified EU classification system of sustainable economic activities (taxonomy), improving disclosure requirements on how institutional investors integrate environmental, social and governance (ESG) factors in their risk processes and creating a new category of benchmarks which will help investors compare the carbon footprint of their investments.

More recently, in July 2021, the European Commission **adopted a number of additional measures** to increase its level of ambition on sustainable finance. The new Sustainable Finance Strategy set out several initiatives to tackle climate change, and other environmental challenges, The European Green Bond Standard proposal was designed to create a high-quality voluntary standard for bonds financing sustainable investment.

Finally, last July, the Commission put forward **a new package of measures to build on and strengthen the foundations of the EU sustainable finance framework**. The aim of this package is to ensure that the EU sustainable finance framework continues to support companies and the financial sector, while encouraging the private funding of transition projects and technologies.

It has been five years since the first Action Plan was published and the Oxford Panel Discussion will be a good opportunity to **revise what has been achieved and the areas where we need to keep working on**.

Securities markets have an important role to play in the transition to more sustainable and inclusive growth. This involves the development of sustainable finance so as to facilitate an appropriate re-routing of capital flows to finance the necessary transformation of the economy. In this sense, we also need to highlight the **extraordinary work that has been developed by IOSCO, ESMA and the national supervisors**.

IOSCO is the international standard setter for capital markets and together with the G20 and the FSB, we set the global regulatory reform agenda for financial markets.

Its membership is made up of over 130 jurisdictions, oversees 95% of the world's capital markets. Reflecting the responsibilities of its members, IOSCO's objectives include investor protection, maintaining fair, efficient and transparent markets, and seeking to address systemic risks.

In October 2018, the Board established the SFN to provide a forum for members to exchange experiences and gain a better understanding of, and have structured discussions on, various sustainability issues.

In 2020 IOSCO decided to establish a Board-level Task Force with a mandate to promote the two main objectives: **(i) addressing transparency**, including how to improve greater comparability of disclosures in light of the lack of consistency and comparability across third party frameworks and (ii) **promoting investor protection**.

In July IOSCO Board decided to endorse the ISSB's final standards and calls on members to consider ways in which they might adopt, apply or otherwise be informed by the ISSB Standards.

ESMA is also actively contributing to the development of the sustainable finance rulebook and effective supervision by making use of its regulatory and convergence toolkit as necessary.

- Promoting transparency and tackling greenwashing
- Building NCA's and ESMA's capacities
- Monitoring, assessing and analysing ESG markets and risks

It has produced Progress Report on Greenwashing and it is also working on Capacity building- Knowledge hub.

Finally, The CNMV is concentrating its efforts on revitalising the use of capital markets by companies, mainly innovative SMEs with capacity for growth, so that the Spanish economy successfully faces its transformation towards a more sustainable economy.

For this transition, significant participation from the capital markets is necessary, participation that is intended to be promoted through different initiatives both at national and European level.

One of the cross-cutting priorities is the identification and monitoring of potential greenwashing practices in the different parts of the value chain.

It should also be noted that during 2023, complementary actions are being carried out to the supervisory activities in the field of sustainable finance, with emphasis on the risk of greenwashing:

- Special contribution to international groups dedicated to the analysis and understanding of this material.
- Identification of possible practices related to greenwashing throughout the value chain in order to contribute to work at the international level.
- Monitoring and analysis of sustainability-related complaints.
- Guidance to supervised institutions and promotion of dialogue.
- Investor education activities, such as the development of educational resources for a proper understanding of ESG products.

Final Report
Overcoming the main ESG investing challenges

MEMBERS

This document is the result of the work carried out by members of the GET-2 ESG Think-Tank. It also reflects the contributions made by the Oxford/23 Congress participants during the congress' deliberations and in the review phase afterwards.

Speakers

- **Sergio Aratangy Rosenberg**, Head of Financial Division, Chilean Pension Funds Superintendence
- **David de Miguel Rato**, Deputy Director, Policy and Sustainable Finance, CNMV

Technical coordinator

- **Ana Rivero Fernández**, Global Technical Coordinator of the Global ESG Think-Tank - GET-2.

This report is signed in a personal capacity and does not represent the official position of the institutions or entities to which the members of the group belong.

GET²
Global ESG Think-Tank
Finance and Law Engaging our Society

FINAL REPORT

Oxford/23: Overcoming the main ESG investing challenges

Situation of ESG in Latam to be discussed by Asset Managers and Industry Players

Report:

Situation of ESG in Latam to be discussed by Asset Managers and Industry Players

INTRODUCTION

We analysed the current landscape of Environmental, Social, and Corporate Governance (ESG) practices in Latin America. Amidst global uncertainties such as the ongoing pandemic and geopolitical conflicts, institutional investors in the region are increasingly embracing ESG considerations as integral aspects of their investment strategies. This paradigm shift signifies a departure from the traditional exclusive focus on profitability and security towards a more holistic, sustainable, and long-term approach to investment.

ESG AND EXPECTED PROFITABILITY

The incorporation of ESG criteria in the investment decisions of asset managers has become a practice that allows them to better manage the savings of their members (because of the expected increased profitability in the long-term, as a result of including all the risks involved in their fiduciary duty) and, in turn, contribute to the development of more sustainable economies. This trend is further underscored by the substantial growth of the Principles for Responsible Investment (PRI), which now boasts over 5,000 signatories globally, managing more than USD 100 trillion in Assets Under Management (AUM). Since its inception in 2010, PRI has played a pivotal role in promoting responsible investment in the region, initially in Brazil and later expanding its influence across Latin America.

TRENDS IN SUSTAINABLE INVESTMENT

Two major trends underpin the burgeoning sustainable investment ecosystem in Latin America:

(i) Private Pension Funds' Embrace of ESG

Private pension funds, a cornerstone of the financial landscape in the region, have emerged as key proponents of ESG integration. These entities, driven by a sense of fiduciary duty and a commitment to the long-term welfare of their members, recognise the importance of including ESG factors in investment decision-making. By doing so, they not only manage their affiliates' savings more effectively but also

contribute to the development of sustainable economies. Currently, 18 pension fund administrators from seven different Latin American countries have subscribed to the PRI, solidifying their commitment to ESG-based investment strategies.

(ii) Adoption of ESG Levers

Several Latin American countries have introduced ESG levers to foster sustainable finance:

Public-Private Partnerships: Collaborations between governments, financial authorities, central banks, and representatives from the financial and pension sectors have led to knowledge exchange and the development of best practices for integrating ESG aspects into financial and investment decisions. Examples include Chile's "Mesa Público Privada de Finanzas Verdes," Colombia's "Task Force de Inversión Responsable," and Mexico's "Red para Enverdecer el Sistema Financiero" and "Comité de Finanzas Sostenibles."

Development of Green Taxonomies: Numerous countries in the region are working on green or sustainable finance taxonomies to classify financial instruments as "green" or "sustainable." These taxonomies facilitate transparency, prevent greenwashing, and enable investors to compare alternatives effectively. The recent publication of the "Common Framework for Sustainable Finance Taxonomies for Latin America and the Caribbean" by the United Nations Environment Programme Finance Initiative is a notable example of such efforts.

Regulatory Initiatives: Regulatory initiatives have been enacted to promote ESG integration, including regulations by pension supervisors that mandate the incorporation of ESG factors in the investment and risk management policies of pension fund administrators. Additionally, issuers of publicly offered securities are now required to include sustainability and corporate governance measures in their annual reports.

Challenges Ahead

Despite these advancements, Latin America faces various challenges in its ESG journey, such as the need for improved access to standardized ESG information, alignment of investor criteria, capacity-building for ESG integration, and knowledge dissemination.

ADVANCED COUNTRIES IN ESG INTEGRATION

Brazil, Chile, Mexico, Colombia, and Peru have emerged as frontrunners in ESG integration:

Brazil: Brazil has been proactive in sustainable finance for over a decade, with milestones such as the establishment of the Green Protocol and the prioritization of ESG issues for pension funds. Regulatory advancements and an emphasis on positive and negative investment filters underscore the country's commitment to ESG.

Chile: Chile is advancing towards international best practices in ESG, with a particular focus on gender equity, governance, and disclosure. Pension fund administrators in Chile are actively promoting ESG through various initiatives and have made strides in sustainable fund investments.

Mexico: Mexico is witnessing the integration of ESG factors into government policies, company operations, and investment strategies. Regulatory changes, the establishment of responsible investment subcommittees, and forthcoming ESG certifications reflect Mexico's commitment to ESG.

Peru: In Peru, pension fund administrators have embraced ESG factors through regulatory provisions that require the integration of ESG risk factors into investment policies. This includes periodic evaluations of the impact of ESG integration on risk profiles.

Colombia: Colombia has made notable progress in creating a conducive regulatory environment for sustainability. Initiatives like the Green Protocol, the issuance of green bonds, and the development of a green taxonomy demonstrate Colombia's commitment to ESG principles.

FIAP'S ROLE AND PLANS

FIAP closely monitors ESG initiatives, including those organized by Fide and the University of Oxford. To disseminate these findings effectively, FIAP plans to communicate results through its social networks, member institutions, regulatory authorities, and international organizations. Additionally, FIAP envisions hosting roundtable discussions where key stakeholders can share insights and progress on ESG matters.

Future Steps for ESG Development

To foster ESG development in Latin America, FIAP recommends several key steps:

1. Establish clear and standardized regulations that promote ESG integration across financial entities.
2. Implement comprehensive training programs to equip financial professionals with the knowledge and skills needed for effective ESG adoption.
3. Promote transparent information disclosure on ESG matters across the financial sector.

4. Raise awareness and understanding of ESG concepts within society, emphasizing their impact on financial results and long-term sustainability.
5. Encourage issuers to report ESG information in line with global standards, facilitating institutional investors' evaluations.
6. Standardize data and evaluation metrics related to ESG criteria to prevent "greenwashing."
7. Develop thematic fixed-income instruments, such as green and sustainable bonds, to channel resources towards sustainable development projects.

In conclusion, Latin America is poised for a transformative shift towards sustainable finance, with various countries making significant strides in ESG integration. While challenges persist, continued collaboration, regulatory support, and knowledge dissemination will play crucial roles in shaping the region's sustainable financial future.

ESG PROGRESS IN LATAM - A PERSPECTIVE FROM CUPRUM

Introduction

We explored the state of ESG in Latin America, we now turn to the perspective of Cuprum, a Chilean Pension Fund manager(AFP), embracing best practices in responsible investment. While Latin America may lag behind some other regions, there is tangible progress towards responsible investment, reflecting a growing interest and commitment across the region.

The Growth of ESG Interest

Cuprum's engagement with the Principles for Responsible Investment (PRI) exemplifies the region's evolving ESG landscape. In 2019, Cuprum was one of just 15 signatories in Latin America (excluding Brazil). However, this number has surged to 128 by June of the current year. This increased interest and commitment have manifested in various stages of responsible investment:

Analysis: A significant milestone in Chile's regulatory framework is General Norm 461 by the Commission for the Financial Market. This regulation mandates Chilean public companies to incorporate sustainability and governance issues into their annual reports, following the Sustainability Accounting Standards Board (SASB) standards. The gradual implementation of this regulation has seen companies include sustainability aspects in their 2022 reports, enhancing transparency and providing investors with relevant material information for investment analysis.

Evaluation: The implementation of standards-based regulations has enabled companies to focus on disclosing financially material information. This focus simplifies access to such information for investors and directs their attention to critical data.

Engagement: Engagement, once a lesser-known concept in Chile, is gaining prominence among both investors and companies. Collaborative engagement initiatives, like the one Cuprum participated in last year, have garnered attention within the region. These initiatives pave the way for greater engagement in smaller and less developed markets, such as Chile, and the lessons learned here can guide the adoption of best practices across Latin America.

Monitoring: Engagement efforts have fostered closer relationships between investors and companies, enhancing the accuracy and effectiveness of monitoring activities.

Reporting: Chilean Pension Fund Managers (AFP) are required by General Norm 276 to report on the risks and factors, including environmental, social, governance, and climate change risks, considered in their investment decisions. This regulatory requirement incentivizes major market players like AFPs to advance in ESG incorporation and transparency.

Continuous Training: The increasing number of PRI signatories in Latin America has facilitated greater networking opportunities and the sharing of best practices. The region has witnessed a notable growth in regional seminars and webinars focused on responsible investment, providing valuable education and insights. The emergence of numerous ESG experts in the region has further enriched the discourse on responsible investment.

Challenges in ESG Implementation

As an ESG Specialist at AFP Cuprum, the main challenges I have experienced can be categorized into two groups: external and internal.

External Challenges:

Finding Material and Standardized ESG Information: While the Chilean regulator is actively addressing this challenge through new disclosure regulations for local companies, there is still room for improvement and adaptation. Investors consider it crucial to access material, standardized, and consolidated information to make informed investment decisions.

Internal Challenges:

Balancing Standardization and Accuracy: AFP Cuprum manages a diverse portfolio of assets, each requiring a unique approach to ESG analysis. Different asset classes and varying materiality levels within each class demand tailored methodologies. The challenge lies in striking a balance between standardized processes, which cover the majority of cases, and ensuring the accuracy of evaluations. Achieving this balance is vital for effective ESG integration.

The Contribution of ESG for Asset Managers

As a Pension Fund Manager, AFP Cuprum recognizes that its success hinges not only

on financial performance but also on its relationship with society. ESG or sustainability has always been integral to its operations. Recent years have witnessed the formalization of ESG processes and analysis, enhancing the robustness of investment processes. Additionally, ESG has opened a new channel for dialogue between investors and companies, fostering discussions on sustainability issues through engagement efforts.

Steps for Efficient ESG Development in Latam

Efficient development and implementation of ESG in Latin America require concerted efforts and cooperation among various stakeholders. Key steps include:

1. **Improving Disclosure and Consolidation**: Actively involve and align government, companies, investors, and regulators to enhance disclosure and consolidate useful and material ESG information.
2. **Effective Regulation Implementation**: Ensure that regulations, like those in Chile, are effectively enforced, requiring companies to adapt and gather new information.
3. **Investor Preparedness**: Investors must be prepared to process the influx of new information resulting from regulatory changes and incorporate it into their investment decisions.

In conclusion, Latin America's ESG journey is marked by promising developments, driven by growing interest and commitment. To ensure sustainable progress, the region must address both external and internal challenges while fostering collaboration and transparency among stakeholders.

MEMBERS

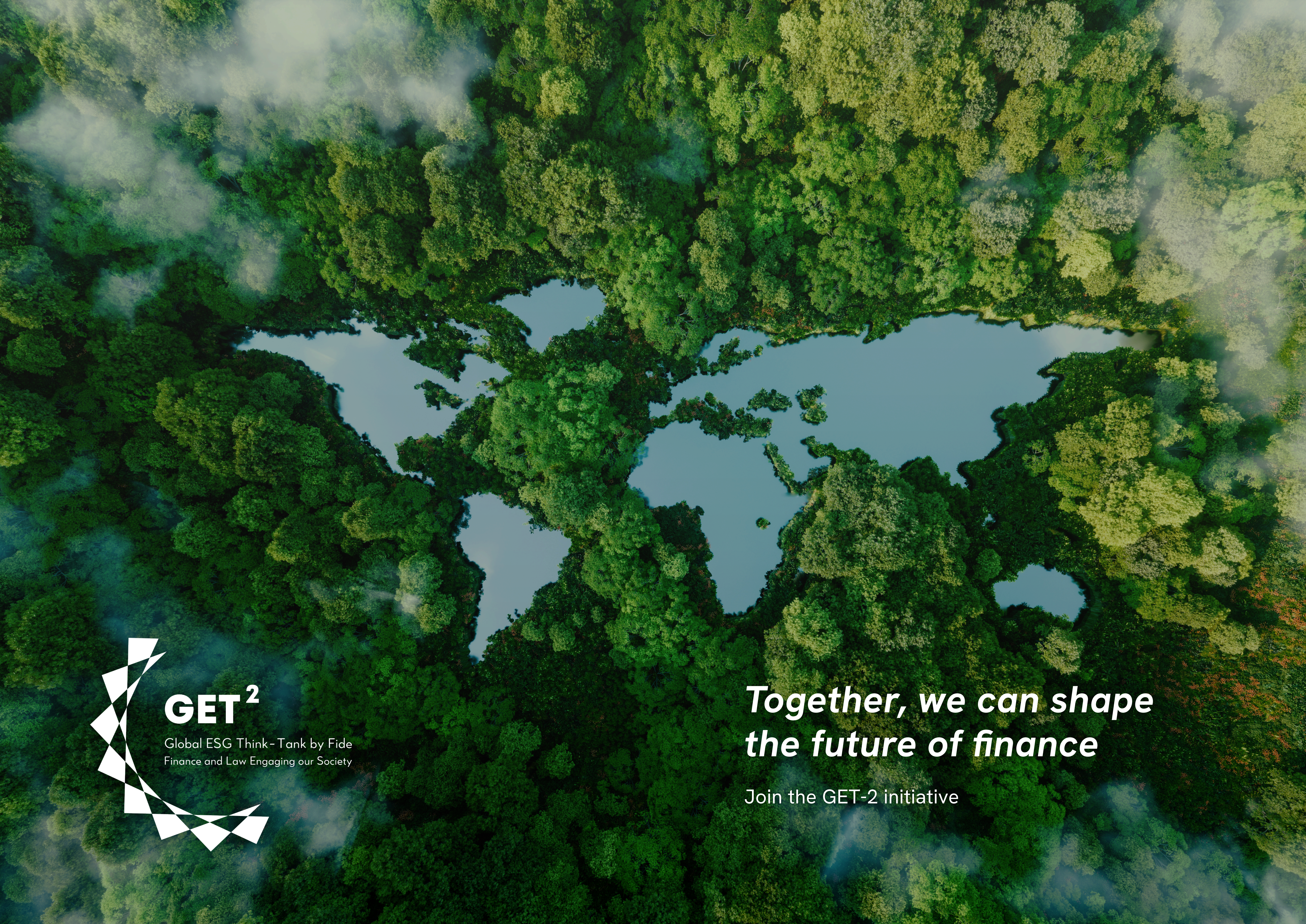
This document is the result of the work carried out by members of the GET-2 ESG Think-Tank. It also reflects the contributions made by the Oxford/23 Congress participants during the congress' deliberations and in the review phase afterwards.

Speakers

- **Daniela Mohr**, Senior Responsible Investment Analyst at AFP Cuprum.
- **Guillermo Arthur**, President of the International Federation of Pension Fund Administrators (FIAP).
- **Gonzalo Rengifo**, Head of Distribution - Iberia, LATAM at Pictet Asset Management.

Technical coordinator

- **Ana Rivero Fernández**, Global Technical Coordinator of the Global ESG Think-Tank - GET-2.


GET 2
Global ESG Think-Tank by Fide
Finance and Law Engaging our Society
Together, we can shape the future of finance
Join the GET-2 initiative

GET² Global ESG Think-Tank
Finance and Law Engaging our Society

GET-2 ESG Think-Tank participants

GET-2 ESG THINK-TANK PARTICIPANTS

This document has been prepared by professionals who are part of the Fide Foundation's Global ESG Think-Tank Road to Oxford Programme. In this section, we wish to highlight them all, acknowledging their vast contributions to the project.

Below, we share the complete list of professionals who have participated in this document, either by being part of one of the working groups, or by having attended the 2023 Oxford Congress and shared their views with the rest of the congress' attendees.

We wish to thank them all for their invaluable insights, with a special acknowledgement to all the Working Group Leaders (highlighted in green):

DIRECTORS:

- Juan Ramón Caridad, Member of Fide´s Board. Managing Director at GAM Investments
- **Ana Rivero Fernández**, Global Technical Coordinator of the Global ESG Think-Tank - GET-2
- **Cristina Jimenez Savurido**, President and Founder of Fide Foundation

PARTICIPANTS:

- **Pablo Alonso Montes**, Senior Manager in KPMG
- **Eduardo Antón**, Vice President - Product Solutions - Wealth Management. Itaú Unibanco IEB
- **Sergio Aratangy Rosenberg**, Head of Financial Division, Chilean Pension Funds Superintendence
- **Guillermo Arthur**, President of the International Federation of Pension Fund Administrators (FIAP)
- **Rita Azahar Hamden Villalobos**, Responsible Consultant at Novaster Mexico
- **Marisa Balzarini**, Head of Sustainability at Sura Asset Management
- **Clotilde Bobineau**, SRI Analyst at VidaCaixa
- **Elena Carranza**, Marketing Manager Iberia, Columbia Threadneedle
- **Víctor Augusto Cos Montiel, CFA**. Director of Risk Management Process Supervision and Financial Inspection at CONSAR
- **Guendalina Boris**, Chairwoman and General Director of Inversis Gestion

- Eric Borremans, Head of Environmental, Social & Governance, Pictet Asset Management
- **Álvaro Carbón Ripepi**, Executive Director of GAM Investments
- **Rodrigo Chávez**, Head of Financial Risk Department at the Superintendency of Pensions of Chile
- Mike Clark, Founder Director, Ario Advisory
- **Ben Constable-Maxwell**, Head of Impact Investing, M&G Investments
- **Clara Crespo Ruiz de Elvira**, Economic and Commercial Counsellor, Embassy of Spain in Washington DC
- **David de Miguel Rato**, Deputy Director, Policy and Sustainable Finance, CNMV
- **Carlos Diaz Núñez**, Global Hed of Product in Santander Asset Management.
- **Raúl Alfonso Espinoza Estrada**, Head of strategy investments at Operadora de Pensiones Complementarias de la CCSS
- **Carolina Fernández**, Legal advice Inverco
- **Sandra Fernández**, Marketing & Client Servicing Manager at Pictet Asset Management
- **Guillermo Fernández Zubia**, Financial Sector Analyst at The World Bank Group
- **María Pilar Galán Gavilá**, Partner Head of Financial Services Legal at KPMG Spain
- **Carlos Garay Gómez-Arroyo**, Responsible for ESG investments at Sabadell Urquijo Gestión
- **Eduardo García Hidalgo**, Global Chief Investment Officer at BBVA Asset Management
- **Rubén García Páez**, Head of Iberian & Latam Distribution at Columbia Threadneedle
- **Alberto Gómez Reino**, Head of Sustainable Investments at BBVA AM
- María José Gómez Yubero, Head of Resolution, Benchmarks and Financial Stability Issues at the National Securities Market Commission (CNMV)
- **Andrea González González**, Deputy Director General at SpainSIF
- **Luis González González**, Head of Sustainability at BBVA Quality Funds
- **Asunción González**, Head of Economic Studies at AMAFORE
- Eva M. Gutiérrez, Lead Financial Economist at the World Bank
- **Ana Guardia**, Head of Capital Markets, ICO

- **Ana Guzmán Quintana**, Head of Impact Investments, Portocolom AV
- **Guillermo Hermida**, Head of ESG, La Caixa
- **Sara Margarita Hernández Hernández**, Project Leader in the General Directorate of Financial Risk Management at CONSAR
- **Rocío Jaureguizar Redondo**, Sales Manager and ESG Specialist at Pictet Asset Management
- Benjamin Kelly, Director of ESG & Impact Columbia Threadneedle Investments
- **Philip Kemp**, Investment Writer at M&G Investments
- **Naomi Kwan**, Sales Support and interest in ESG at M&G
- **Philippe Le Gall**, Senior ESG Engagement Specialist at Pictet Asset Management.
- **Florenica López André**, Risk Control Manager at ATL Capital
- **Stephanie Maier**, Global Head of Sustainable and Impact Investment, GAM Investments
- **Jaime Martínez Gómez**, Global Head of Asset Allocation. BBVA Asset Management
- **Roberto Mendoza**, Investment and Risk Director at AMAFORE
- **Gonzalo Meseguer Muñoz**, General Manager at Santalucía AM
- Daniela Mohr, Senior Responsible Investment Analyst at AFP Cuprum
- **Carlos Montalvo Rebuelta**, Partner PwC
- **Javier Moraga Ramírez**, Head of Fund Selection & ESG Integration at AFP Cuprum
- **Carlos Moreno**, Sales Director Iberia, Columbia Threadneedle Investments
- **María Noel Urban**, Alternative Asset Investment Specialist, AFAP SURA
- **Eric Osio Cerón**, General Director of Risk Management at CONSAR
- **Laura Palomo Aguado**, Legal Advisor at the Spanish Association of Collective Investment Schemes and Pension Funds (Inverco)
- **Valdemar Perot**, Investment Analyst at AFP HABITAT
- **Cristian Ramírez**, Financial Risk Analyst at the Superintendency of Pensions of Chile
- **Gonzalo Rengifo Abbad**, Head of Distribution - Iberia, LatAm at Pictet Asset Management
- **Paula Rienzi**, Credit Risk Specialist at SURA Uruguay.

- **Gizelle Rivera Contreras**, Deputy Director of Financial Research at the Financial Vice-Presidency of CONSAR
- Ignacio Rodríguez Añino, Responsible for the Commercial Development of M&G Investments in Spain and Latin America
- **Laura Sacristán Martín**, Chief Commercial Officer at Grupo BME-SIX
- **Gloria Sánchez Soriano**, Senior Advisor of the Digital Finance Department at the Institute of International Finance – IIF
- **Agustín Sheppard Gelsi**, Chief Risk Officer of Unión Capital AFAP S.A
- **Faisel Syed**, ESG Specialist at Pictet Asset Management
- **Manuel Tabilo**, Research Manager at FIAP
- **James Upton**, Senior Corporate Governance Specialist, Pictet Asset Management
- **Belén Vila Martínez**, Fund Analyst in Banco Santander
- **Manuel Zapata**, Financial Analyst at the Superintendency of Pensions of Chile

Furthermore, this document is signed in a personal capacity and does not represent the official position of the institutions or entities to which the members of the group belong.

The document reflects not only the work done but also the analysis carried out, providing conclusions and justifications, considering the personal experience of the members of the group.

FIDE'S TEAM:

Below are the members of Fide's team that have participated in this initiative:

- **Alvaro Arribas**, Marketing and Digital Development at the Fide Foundation
- **Cristina Arribas**, Academic Coordinator at the Fide Foundation
- **Victoria Dal Lago**, Academic Director at the Fide Foundation
- **Carmen Hermida,** Managing Director at the Fide Foundation
- **Lucía Hernández**, Academic Coordinator at the Fide Foundation
- **Blanca Jimenez**, Marketing assistant at the Fide Foundation

ABOUT THE FIDE FOUNDATION

Fide serves as a perpetual meeting ground for seasoned professionals with extensive career experience in various sectors, particularly in law and business. It functions as a legal-economic think tank, providing a platform for practical knowledge exchange. This is made possible through active engagement from individuals across civil society, including corporate leaders, legal experts, academia, public administrators, and professionals with expertise in the legal and business domains.

Fide has established a series of working groups, each tasked with conducting continuous and in-depth reflections on pressing issues. These issues have been identified as needing urgent attention, reform, or enhancement. The composition of these working groups is carefully curated, comprising professionals with substantial expertise in their respective fields.

The findings from these working groups have yielded various outcomes, from universally accepted conclusions to specific regulatory proposals and initial situational analyses. These contributions serve as valuable resources for professionals involved in the evolution, development, application, or enhancement of regulations, particularly in economic regulation.

Members of these working groups are actively engaged with Fide, participating in its sessions and forums that closely align with the specific areas of analysis. This active participation fosters knowledge sharing and dissemination, benefiting those who play a role in the evolution of regulations and economic development.

Visit Fide's Website

GET-2 COLLABORATING ENTITIES

Columbia Threadneedle Investments is a leading global asset management group that provides a broad range of actively managed investment strategies and solutions for individual, institutional and corporate clients around the world. Our focus is on meeting our clients' expectations through a team-based, risk-aware and profit-oriented approach.

With a workforce of more than 2,000 employees, including more than 450 investment professionals based in North America, South America, Europe and Asia, we manage assets in equities, fixed income, asset allocation solutions and products. alternatives from emerging and developed markets.

Columbia Threadneedle Investments is the global asset manager of Ameriprise Financial, Inc. (NYSE:AMP), a leading U.S.-based financial services company. Being part of Ameriprise, we are supported by a large financial services company widely diversified and capitalized.

For more information: Visit their Website

Pictet Asset Management is an independent asset manager, overseeing investments across a range of equity, fixed income, alternative and multi asset products on behalf of our clients, whose purpose is to build responsible partnerships with our clients, colleagues, communities and the companies in which we invest.

They are part of the Pictet Group, an investment-led services group founded in Geneva in 1805 whose unique partnership structure has provided the stable foundation for long-term thinking.

For more information: Visit their Website

GAM Investments is an independent, pure play asset management group created in 1983 with the purpose of protecting and enhancing our clients' financial future. GAM's core investment strategies focus on fixed income, equity, multi asset & solutions and systematic, and include environmental, social and governance (ESG) factors. By attracting and empowering the brightest minds to think beyond the obvious, GAM strives to provide investment leadership, innovation and a positive impact on society and the environment. By living our purpose every day, we believe that we can realise our vision of building the most respected specialist active investment manager and trusted solutions and services platform in the world.

For more information: Visit their Website

Final Report
Overcoming the main ESG investing challenges

GET-2 COLLABORATING ENTITIES

M&G Investments is a global asset manager, serving customers and clients for more than 90 years since launching Europe's first ever mutual fund back in 1931. We're part of M&G plc, a family of brands, all aligned behind the same ambition: to manage our customers' investments so that they can live the life they want, while aiming to make the world a little better along the way. Through long-term active investment management, we build solutions around what matters most to our customers and clients, looking for the best opportunities to invest in, across a wide range of asset classes.

For more information: Visit their Website

The International Federation of Pension Fund Administrators (FIAP) brings together the associations and entities that manage pension funds from 10 countries (Bolivia, Costa Rica, Chile, El Salvador, Spain, Kazakhstan, Mexico, Peru, the Dominican Republic, and Uruguay). Its objective is to collaborate in the improvement and consolidation of pension systems based on individual savings, to offer the best possible pension to workers, within a financially sustainable system and contributing to the economic growth and development of the countries.

For more information: Visit their Website

Instituto BME is BME's training center and a close collaborator of the National Financial Education Plan in Spain. It focuses on training services relating to finance and financial markets. The training programs promoted by Instituto BME are aimed at professionals in the financial sector and its regulatory bodies, individual investors, students, and anyone interested in entering or deepening their knowledge of the world of finance. Instituto BME further expanded its course platform Braindex, which offers an online educational environment. Braindex offers 85 courses with different levels. Around 25% of the courses on Braindex are accessible free of charge. All the courses both in Instituto BME and Braindex have the following thematic axes: markets and products, technology applied to financial markets and financial regulation. In this way, BME facilitates the development of society's financial skills, promoting a better understanding of financial products, concepts, and risks through training, instruction, and advice.

For more information: Visit their Website

GET²
Global ESG Think-Tank
Finance and Law Engaging our Society

Oxford/23 Congress Report

OVERCOMING THE MAIN ESG INVESTING CHALLENGES

An initiative by the Fide's GET-2 ESG Think-Tank