# Sustainable finance in emerging markets and the role of securities regulators

**A report on Sustainable finance in emerging markets and the role of securities regulators sets forth key recommendations related to the development of sustainable finance**

## Background

The International Organization of Securities Commissions (IOSCO) was established in 1983, when 11 securities regulatory agencies from North and South America agreed to build their inter-American regional association into an international cooperative body. A year later, securities regulators from France, Indonesia, Korea and the United Kingdom become the first non-American agencies to join the new organization.

Its membership regulates more than 95% of the world's securities markets in more than 115 jurisdictions; securities regulators in emerging markets account for 75% of its ordinary membership and it continues to expand. As such, IOSCO is the leading international policy forum for securities regulators and is recognized as the global standard setter for securities regulation.

The IOSCO Objectives and Principles of Securities Regulation have been endorsed by both the G20 and the FSB as the relevant standards in this area. They are the overarching core principles that guide IOSCO in the development and implementation of internationally recognized and consistent standards of regulation, oversight and enforcement. They form the basis for the evaluation of the securities sector for the Financial Sector Assessment Programs (FSAPs).

The IOSCO Board is the governing and standard-setting body of the International Organization of Securities Commissions (IOSCO), and is made up of 34 securities regulators.

IOSCO aims through its permanent structures:

- to cooperate in developing, implementing and promoting adherence to internationally recognized and consistent standards of regulation, oversight and enforcement in order to protect investors, maintain fair, efficient and transparent markets, and seek to address systemic risks;
- to enhance investor protection and promote investor confidence in the integrity of securities markets, through strengthened information exchange and cooperation in enforcement against misconduct and in supervision of markets and market intermediaries; and,
- to exchange information at both global and regional levels on their respective experiences in order to assist the development of markets, strengthen market infrastructure and implement appropriate regulation.

The Growth and Emerging Markets (GEM) Committee is the largest committee within IOSCO, representing close to 80 per cent of the IOSCO membership, including 11 of the G20 members. Dr. Obaid Al Zaabi, Chief Executive Officer, Securities and Commodities Authority, United Arab Emirates, is the Chair of the GEM Committee.

In 1998 IOSCO adopted a comprehensive set of Objectives and Principles of Securities Regulation (IOSCO Principles), now recognized as the international regulatory benchmarks for all securities markets.

The agenda for global sustainability has advanced in recent years as policy makers and market participants increase efforts to promote financial markets that support long-term sustainable economic development, including socio-economic and environmental factors, including the need to reorient financial markets to meet global sustainable development needs and deliver long-term and resilient growth.

Globally, securities regulators and exchanges have adopted policy measures to support the development of various aspects of sustainable finance, such as sustainable investment products, and raise the quality, transparency and visibility of information and data on sustainable finance.

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

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

In October 2017, the GEMC established a Working Group on Sustainability in Emerging Markets (WGS) to carry out that work. The project aimed to better understand the issues and challenges that have an impact on the development of sustainable finance in capital markets, focusing on sustainable assets in emerging markets and measures to facilitate progress in this area.

## The Report

IOSCO´s Growth and Emerging Market Committee (GEMC) have published in early June the report **Sustainable finance in emerging markets and the role of securities regulators**, which provides 10 recommendations for emerging market member jurisdictions to consider when issuing regulations or guidance regarding sustainable financial instruments. Among other things, the recommendations include requirements for reporting and disclosure of material Environmental, Social and Governance (ESG) specific risks, aimed at enhancing transparency.

The report explores the trends and challenges that influence the development of sustainable finance in emerging capital markets. It also provides an overview of the initiatives that regulators, stock exchanges, policy makers and others key stakeholders in emerging markets have undertaken in this area. The report identifies the pre-requisites for creating an ecosystem that facilitates sustainable finance, such as an appropriate regulatory framework and fit-for-purpose market infrastructure, reporting and disclosure requirements, governance and investor protection guidelines and mechanisms to address needs and requirements of institutional investors.

Given the global nature of sustainable instruments, the GEMC believes its recommendations will benefit both issuers and investors by improving the consistency of regulation of sustainable finance in emerging markets. It encourages its members to consider implementation of this guidance in the context of their legal and regulatory framework, given the significance of the associated risks and opportunities.

Syed Zaid Albar, Co-chair of the GEMC WGS, stated that 'The GEMC report is a valuable resource for emerging market regulators seeking to facilitate sustainable finance and long-term value growth in their jurisdictions. The report offers recommendations that can help regulators in emerging markets develop key aspects of sustainable finance, including transparency and disclosure of material ESG risks.'[1]

**Review Methodology**

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

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

The GEMC has also considered the responses to the GEMC Consultation Report on Sustainable finance in emerging markets and the role of securities regulators published on 1 February 2019.[2]

**Recommendations**

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

Despite these developments, both the survey results and the GEMC Dialogue indicated that specific recommendations from the GEMC could further help facilitate the development of sustainable finance, including sustainable products and instruments in emerging capital markets, such as green bonds, social impact bonds and ESG funds in emerging capital markets. In this regard, the GEMC has identified the pre-requisites for creating an ecosystem that facilitates sustainable finance in capital markets.

[1] OICV- IOSCO Media Release (2019). Emerging Market regulators issue recommendations related to sustainable finance. IOSCO/MR/15/2019. 5 June 2019, Madrid.

[2] The Growth and Emerging Markets Committee (GEMC) (2019). Sustainable finance in emerging markets and the role of securities regulators Consultation Report. International Organization of Securities Commissions. CR01/2019. February 2019.

Critical components include such things as an appropriate regulatory framework, fit for purpose market infrastructure, reporting and disclosure requirements, governance and investor protection guidelines and mechanisms to address needs and requirements of institutional investors.

These recommendations take into consideration the IOSCO Principles and Methodology,[3] including:

- Principle 16 (for issuers) which requires consideration of the adequacy, accuracy and timeliness of both financial and non-financial disclosures as well as disclosure of risks that are material to investors decisions;
- Principle 26 (for collective investment schemes - CIS) which requires that all matters material to the valuation of a CIS are disclosed to investors and potential investors on a timely basis.

The list of recommendations that GEMC member jurisdictions should consider when issuing regulations or guidance regarding sustainable products and instruments and additional disclosure requirements of ESG-specific risks fall into the following categories:

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

The recommendations are synthesized in the following table:

| | Recommendation |
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| 1 | **Issuers and other regulated entities should integrate ESG-specific issues in overall risk assessment and governance** where these are material, in the overall risk assessment and governance of these entities |
| 2 | Consistent with their fiduciary duties, **institutional investors, including asset managers and asset owners, are encouraged to incorporate ESG-specific issues into their investment analysis, strategies and overall governance** |
| 3 | **Regulators should require disclosure with regard to material ESG-specific risks** (including transition risks) and opportunities in relation to governance, strategy and risk management24 of an issuer |
| 4 | **Sustainable instruments should be clearly defined** and should refer to the categories of eligible projects and activities that the funds raised through their issuance can be used for |
| 5 | **Funds raised through sustainable instruments should be used for projects and activities falling under one or a combination of the broad ESG categories** listed below:<br>▪ Environmental (renewable resources; combatting/mitigating climate change; pollution and waste; and other environmental opportunities);<br>▪ Social (human capital; product liability; and other social opportunities);<br>▪ Governance (corporate governance; corporate behavior). |
| 6 | Regulators should establish **requirements for the offerings of sustainable instruments** including, among others, the use and management of the funds raised through the issuance of such instruments, and the processes used by issuers for project evaluation and selection |

[3] International Organization of Securities Commissions 2017. Methodology For Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation. Pages 104 y 155.

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| 7 | Regulators should establish **ongoing disclosure requirements** regarding the use of the funds raised through the issuance of sustainable instruments including the extent of unutilized funds, if any |
| 8 | **Proper use of funds**. Regulation should provide for measures to prevent, detect and sanction the misuse of the funds raised through the issuance of sustainable instruments. |
| 9 | Issuers should consider the use of **external reviews** to ensure consistency with the definition of the sustainable instruments and eligible projects |
| 10 | **Building capacity and expertise for ESG issues**. Regulators should analyze the gaps in capacity and expertise with regard to ESG-related issues mentioned in the above recommendations and consider targeted capacity building to address these gaps |

In issuing this set of recommendations, the GEMC believes they will help achieve a degree of international consistency and harmonization and thereby assist investors and issuers, given the cross-border and global nature of sustainable instruments.

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

Sources: This note is based on excerpts from the following reports, methodological guidance and press releases:

- International Organization of Securities Commissions (2019). Sustainable finance in emerging markets and the role of securities regulators Final Report. June 2019.
- International Organization of Securities Commissions 2017. Methodology For Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation.
- The Growth and Emerging Markets Committee (GEMC) (2019). Sustainable finance in emerging markets and the role of securities regulators Consultation Report. International Organization of Securities Commissions. CR01/2019. February 2019.
- OICV- IOSCO Media Release (2019). Emerging Market regulators issue recommendations related to sustainable finance. IOSCO/MR/15/2019. 5 June 2019, Madrid.