



ESG Monitor

MONETARY AND CAPITAL MARKETS DEPARTMENT

September 17, 2020

ESG Monitor Highlights

- Green fiscal stimulus to offset the effects of the pandemic is underway in Europe and Korea, with substantial spending toward cleaner transport
- China is set to launch the world's largest carbon trading market later this year
- Support for ESG disclosures is continuing to grow, alongside greater policy action and regulation, but challenges highlight the need for a greater push toward wider adoption
- Investor survey for ESG uptake underscores the mainstreaming of ESG as an investor concept: even investors with no dedicated ESG funds often include sustainability considerations
- ESG debt continues to grow with a surge in social and pandemic-related issuance offsetting the decline in green bond issuance
- Concerns over the labeling of ESG debt underline the need for standardization
- Innovation in green finance: German green sovereign bond, and the European Energy Efficient Mortgage Initiative

Sustainable finance is the incorporation of a broad set of ESG principles in business and investment decisions

1. Selected Environmental, Social, and Governance (ESG) Issues

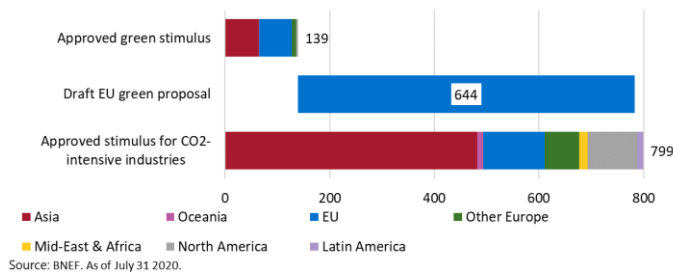
Key Pillars	Key Themes		Key Issues
Environment	Climate change	Carbon footprint	Vulnerabilities from climate change events
	Natural resources	Energy efficiency Sourcing of raw materials	Water efficiency Usage of land
	Pollution and waste	Toxic emissions Wastewater management Hazardous materials management	Air quality Electronic waste management
	Opportunities and policy	Renewable energy Clean technology	Green buildings Environmental and biodiversity targets and investment
Social	Human capital	Workplace health and safety Development opportunities	Employee engagement, diversity, and inclusion Labor practices (e.g., wages, working conditions)
	Product responsibility	Product safety and quality Selling practices and product labeling	Customer privacy and data security Access to products
	Relations	Community Government	Civil society
Governance	Corporate governance	Board structure and accountability Accounting and disclosure practices	Executive compensation and management effectiveness Ownership and shareholder rights
	Corporate behavior	Management of corruption Systemic risk management Earnings quality	Competitive behavior Management of business environment (e.g., legal, regulations) Transparency on tax and related-party transactions

Source: IMF, Global Financial Stability Report (Chapter 6, October 2019).

Government support for green activities could spur growth in ESG finance

Green stimulus stands at \$139 bn and another \$644 bn could be added if EU proposals are ratified.

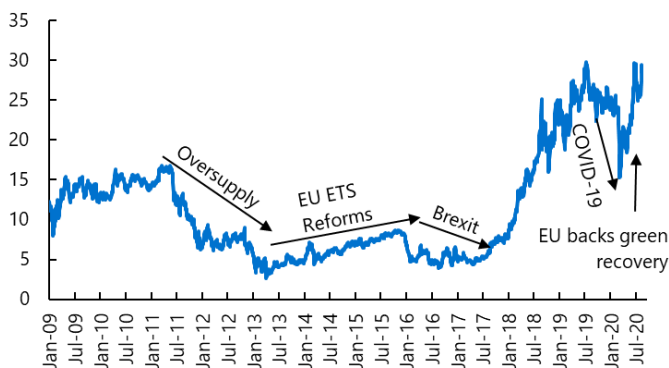
2. Green Stimulus (Billions of US dollars)



- Korea and Germany account for three quarters of green stimulus so far.
- The European Council adopted on July 21 a landmark commitment that 30% of the total expenditure of the EU's 750-billion-euro recovery package and 1-trillion-euro long-term budget will comply with key climate targets (some \$644 billion).

The carbon price in the EU emission trading system recovered quickly from the COVID-19 shock.

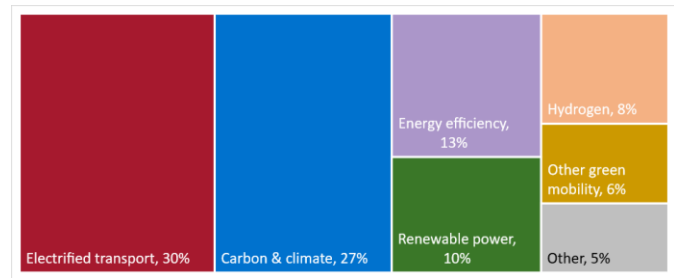
4. Carbon Price in European Union Emissions Trading System (Euro per ton)



- Carbon prices reached record levels with reports of some hedge funds seeing European carbon prices as a "one-way bet" as Europe looks to strengthen its carbon market to deliver on long-term emissions reduction targets.
- The European Commission is expected to recommend more ambitious emission reduction targets this month.

The largest portion of green stimulus is in support for electric vehicles.

3. Approved National and Sub-national Green Stimulus (Target Sector Breakdown, % of Total)

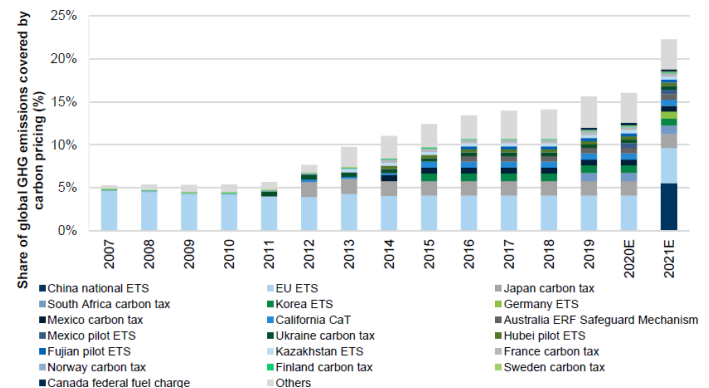


- Many green stimulus programs include support for the electrification of transport (subsidies, R&D).
- Energy efficiency of buildings has been another focus of several economic stimulus packages across the world (e.g. Germany, Denmark, Ireland).

China's national emissions trading system is set to launch by end 2020.

5. Emission Trading Systems (ETS)

(Share of Annual Global Greenhouse Gas Emissions Covered by ETS)

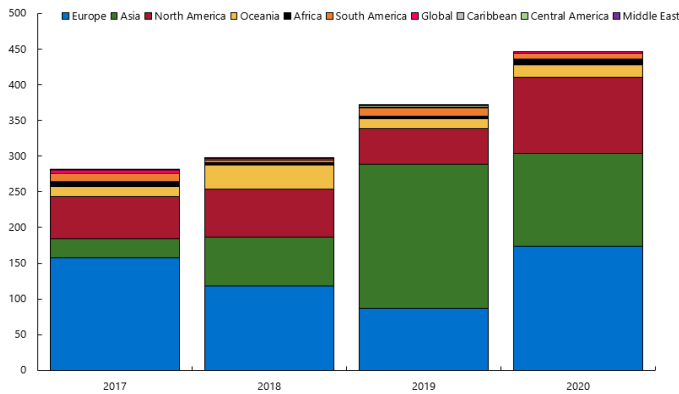


- China's national ETS will launch on December 19, 2020, initially covering coal- and gas-fired power plants.
- It would account for 5% of global greenhouse gas emissions initially, making it the world's largest carbon pricing market.

Support for better climate disclosure is growing

Support for climate related financial disclosures among corporates is rising.

6. Additional TCFD Supporters each Year by Region (2020 as of early Sep)

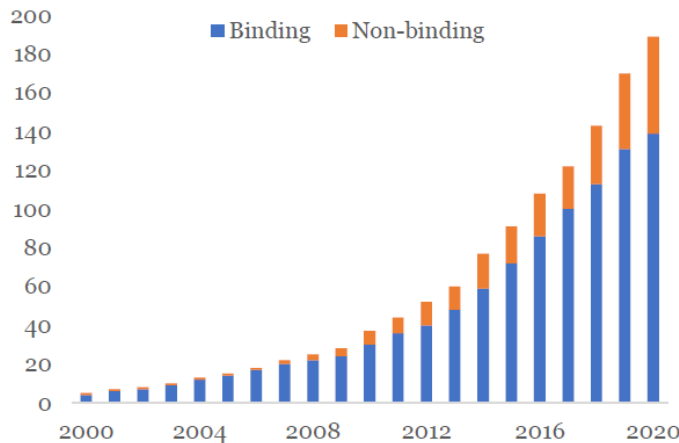


Sources: Task Force on Climate-Related Financial Disclosures (TCFD)

- The FSB Task Force on Climate-related Financial Disclosures (TCFD) develops voluntary, consistent climate-related financial risk disclosures.
- Although multiple frameworks for disclosures underscore the need for a consistent and harmonized set of global disclosure standards, TCFD is currently seen as a benchmark for climate related financial disclosures.

Policy measures relating to disclosures have been rising fast...

8. ESG Disclosure Measures by Compliance Structure

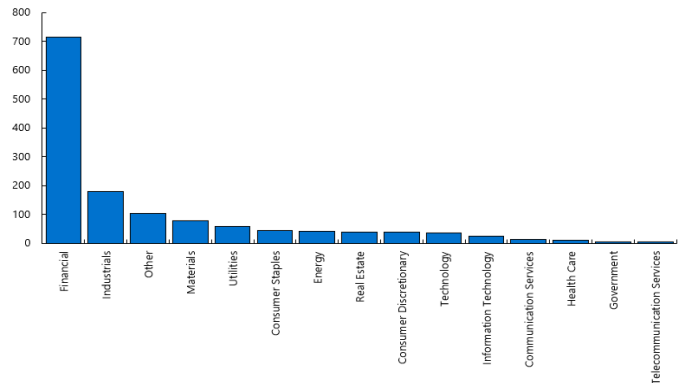


Source: IIF, Building a Global ESG Disclosure Framework, June 2020.

- Disclosure-related policy action has picked up in recent years with nearly 200 measures in effect globally. Recently, measures with a focus on climate change have increased (IIF).
- The European Union has been a leader in enacting hallmark legislation, including on disclosures.

Support has been particularly strong among financial firms.

7. TCFD Supporters by Sector (as of early Sep 2020)



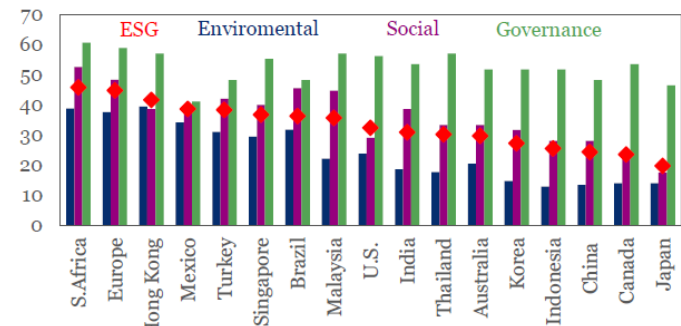
Sources: Task Force on Climate-Related Financial Disclosures (TCFD)

- Governments are encouraging firms to support green disclosures, for example: in Canada, to qualify for the Large Employer Emergency Financing Facility, Canadian firms need to pledge their support for the TCFD. In Korea, the Ministry of Environment signed on the TCFD in a sign of public endorsement.

...and corporate disclosure practices are improving, but remain fragmented and incomplete

9. ESG Disclosures Index

(Country median index of the percent of data points collected by Bloomberg)



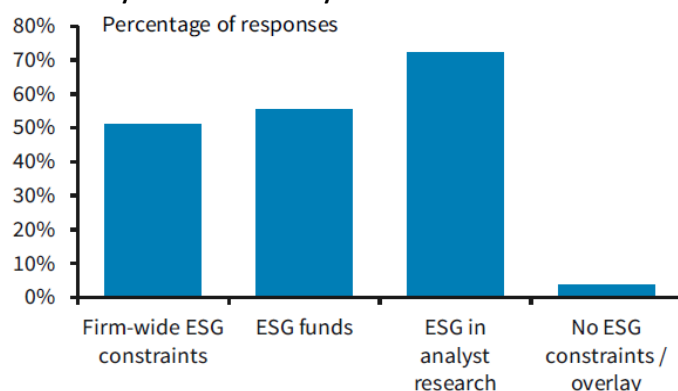
Source: IIF, Green Weekly Insight: The Race for Better ESG Disclosure, Feb 2020.

- ESG disclosures have been steadily improving, but progress has been uneven between countries and the sustainability dimensions ("E", "S", and "G").
- See also October 2019 GFSR, Chapter 6 for more discussion.

Barclays ESG Survey of investors

ESG considerations are increasingly applied firm-wide, not just in dedicated ESG funds.

10. How do you consider ESG at your firm?

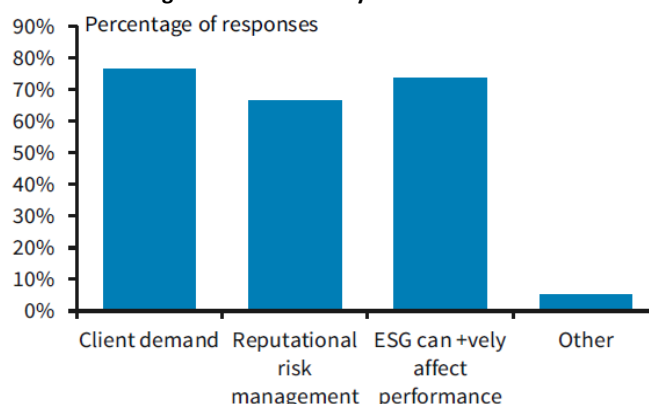


Source: Barclays Research 2020 ESG investor survey

- The majority of the recent growth in ESG investing has come from firm-wide rather than fund-level commitments, as more investors sign up to high level pledges like the UN PRI.
- 50% of respondents have firm-wide ESG constraints, nearly as many as that offer ESG-labelled funds.
- Even investors with no specific ESG funds or firm-wide constraints often include sustainability considerations in their analyst research process.

Investors see three key drivers of ESG investment.

11. What is driving interest in ESG at your firm?

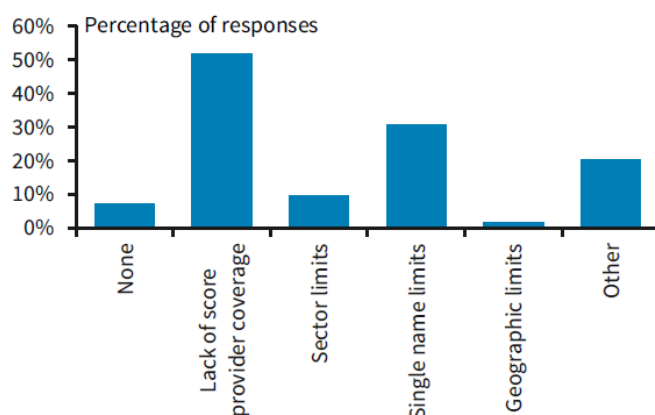


Source: Barclays Research 2020 ESG investor survey

- Investors see three drivers: demand from end-clients, the belief that ESG can positively affect performance, and reputational risk management.
- A majority of respondents ticked all three of those answers.

For credit investors, lack of coverage by ESG score providers is seen as the main hurdle to more ESG investment.

12. Credit: What hurdles are there to increasing the size of ESG investments?

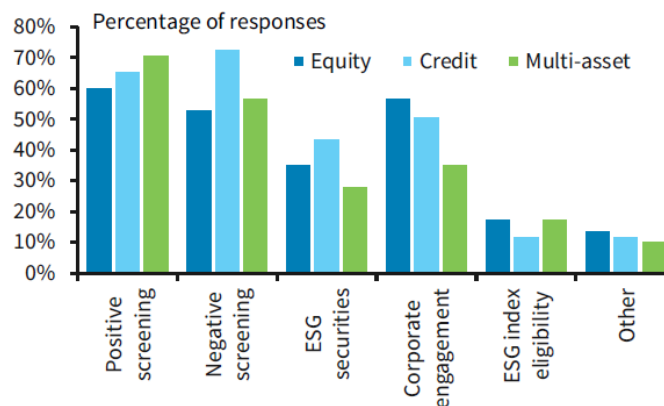


Source: Barclays Research 2020 ESG investor survey

- Credit investors see the lack of ESG score provider coverage as the main hurdle to increasing ESG investment. This is less of an issue for equity investors.
- The majority of "other" responses focused on the lack of standardization in corporate reporting.

Positive and negative (exclusion) screening approaches are most widely used to select ESG securities.

13. By asset class: How do you choose which securities can be bought by your ESG funds?



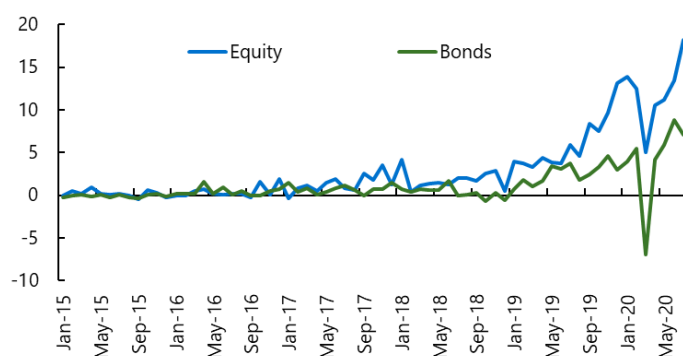
Source: Barclays Research 2020 ESG investor survey

- Positive screening, often based on proprietary scoring approaches, and negative screening, exclusion of sectors such as coal and alcohol, are the most widely used approaches for selecting ESG assets.
- ESG labeling of securities is a less important selection criteria.

ESG fund flows and indices continue outperformance

ESG fund flows reached new highs.

14. Overall Equity and Bond Flows into ESG/SRI Funds (Billions of US dollars; latest end July)

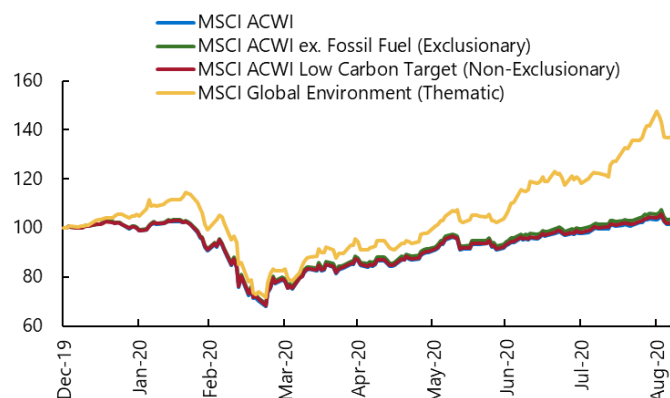


Source: EPFR

- Flows into equity ESG funds surged to almost \$20bn in July.
- This has been largely driven by European-domiciled and large-cap funds.

Climate change-themed global equities performed in line or outperformed conventional global equity indices.

15. MSCI All-Country World Index (ACWI) and Various ESG Indices (Index; Normalized to 100 as of end-2019)

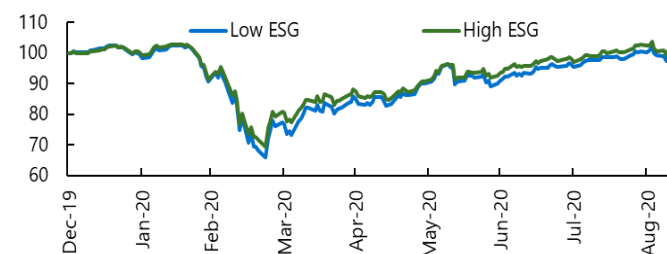


Sources: Bloomberg, IMF staff calculation

- Strong outperformance of the MSCI Global Environment is driven by Tesla which has a 36% weight in the index.

Equities with high ESG scores outperformed since the market crash in March.

16. S&P Global 1,200 Equity (High and Low ESG Baskets) (Index; Normalized to 100 as of End-19)



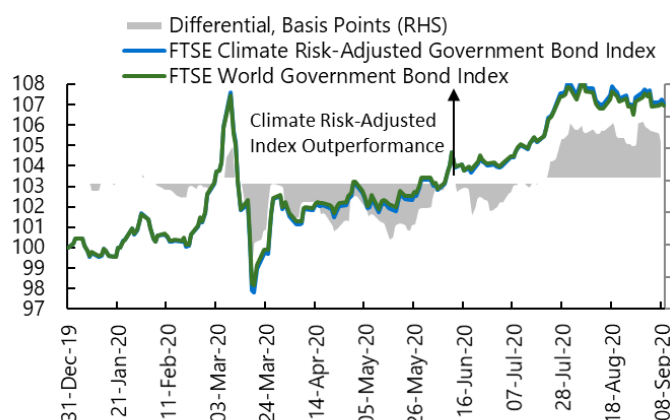
Source: Bloomberg

Note: Indices are created using members of the S&P Global 1,200 Index. High ESG = Average of indices created from 75th percentile scores from RobecoSam, Sustainalytics, Thomson Reuters; Low ESG = Average of indices created from 25th percentile from RobecoSam, Sustainalytics, Thomson Reuters

- Global equities with high ESG scores continued to outperformed equities with low ESG scores, partly due to less exposure to commodities and higher exposure to tech.
- High ESG equities outperformed across advanced economies and EM.

Climate adjusted bond indices started to outperform in Q3.

17. FTSE World Government Bond Index and Climate Adjusted Index (Index; Normalized to 100 as of Jan 2, 2020)



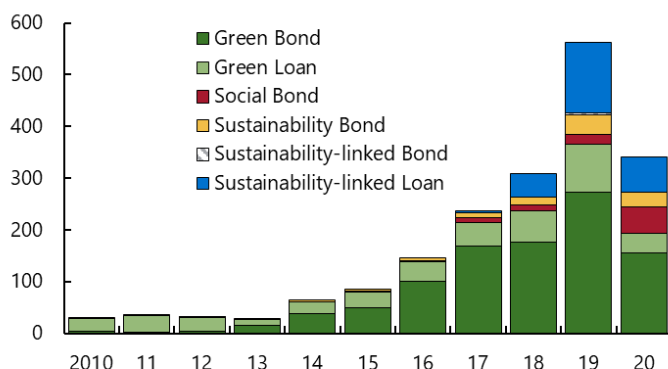
Sources: Bloomberg, IMF staff calculation

- The climate adjusted WGBI tilts toward sovereigns with lower exposure to climate risk. The biggest overweights in the climate index are the UK and Germany, while the US and the Netherlands are the biggest underweights.

ESG debt growth continued with a surge in social and pandemic related issuance. Concerns over the labeling of ESG debt underline the need for standards

Sustainable debt issuance continues to rise.

18. Global Sustainable Debt Issuance (2020 as of August 28)
(Billions of US dollars)

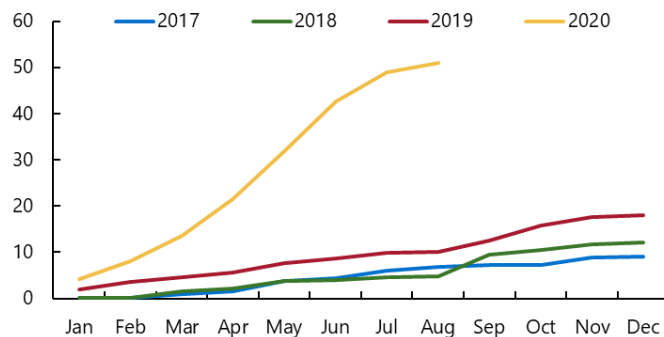


Source: BloombergNEF

- Sustainable debt issuance for H1 2020 rose to \$267bn, 13% higher than \$236bn in the same period in 2019.
- Despite progress on standards, concerns over false claims of greenness or social aspects remain.

Social bond issuances surged in the context of COVID-19.

19. Social Bond Issuances
(Billions of US dollars)

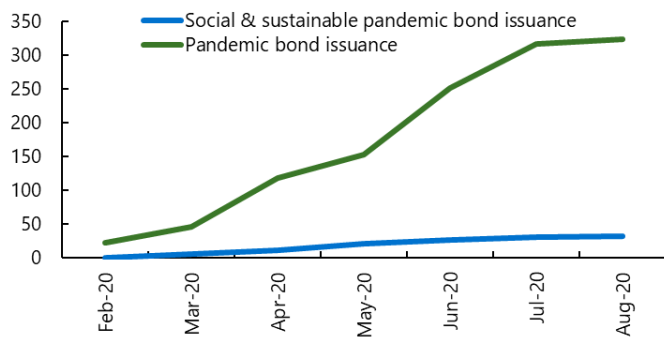


Source: BloombergNEF

- Social Bonds are any type of bond instrument where the proceeds will be exclusively applied to finance or refinance in part or in full new and/or existing eligible social projects.
- Many COVID-19-related issuances stretch previous definitions of 'social' and concerns over 'social-washing' have risen.

Bond issuance labeled as related to COVID-19 has, not surprisingly, surged.

20. Pandemic Bond Issuances
(Billions of US dollars)

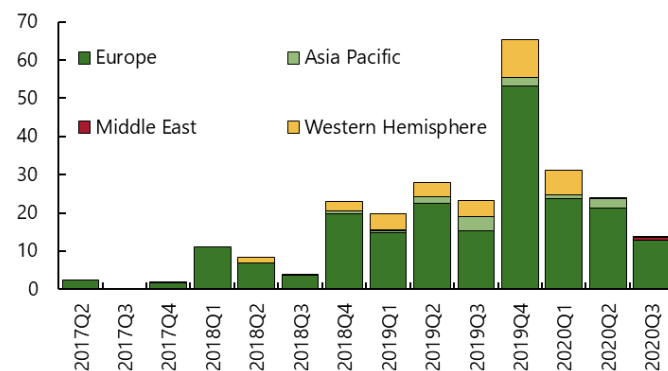


Source: BloombergNEF

- Pandemic bonds is a generic term that includes bonds for which funding is specifically designated for projects in relation to the Coronavirus (COVID-19) outbreak.
- Pandemic bonds are not necessarily classified as ESG debt.
- Some social bonds are also pandemic bonds, but not necessarily.

Sustainability-linked bank loans moderated further from 2019 highs.

21. Global Sustainability-linked Loans (2020Q3 as of August 28)
(Billions of US dollars)

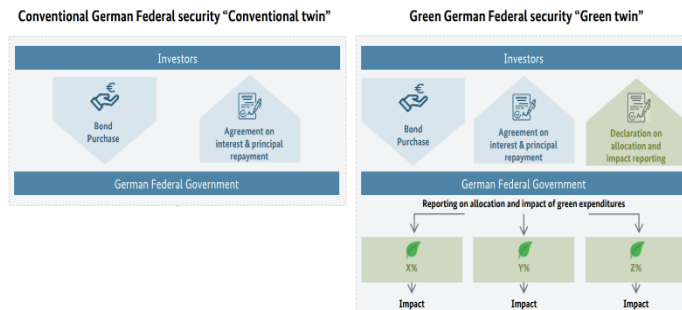


Source: BloombergNEF, IMF staff calculations

- Sustainability-linked loans incentivize the borrower's achievement of predetermined sustainability performance objectives, often through interest rate rebates or penalties.
- Sustainability-linked loan volumes have come off the highs in H1 2020, close to that in the first three quarters of 2019.

Germany debuted a sovereign green bond in September with an innovative feature to ensure liquidity.

22. Illustration of First Green Sovereign Bond by German Federal Government and its 'Conventional Twin'

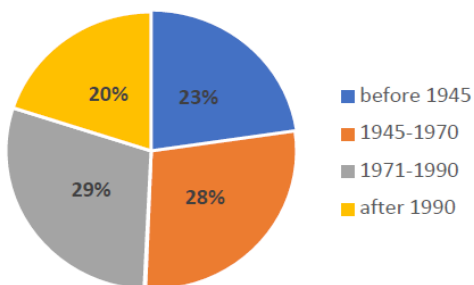


Source: German Federal Government

- Germany issued EUR6.5 bn 10-year green bond in early-September, which was heavily oversubscribed.
- An innovative feature of the bond is that investors will be able to swap their green bonds for the conventional equivalent at any time, a structure designed to allay fears that less liquid green securities would trade at a discount.
- The ministry will ensure the price of the green twin is always at least that of the regular bond, by buying green bonds if their price falls below the conventional twin.
- Bond proceeds will be used for cleantech and energy projects. Germany has committed to regular sovereign green issuance across maturities.

The European Energy Efficient Mortgage Initiative intends to incentivize the improvement of the energy efficiency of residential buildings.

24. Year of Construction of EU-28 Existing Homes

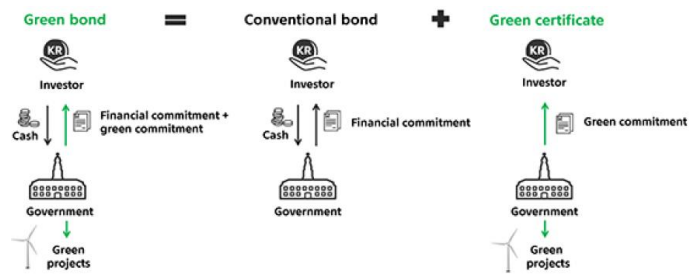


Source: Energy Efficient Mortgages Initiative.

- Half of the EU's housing stock is at least 50 years old, and nearly a quarter is at least 75 years old.
- Finance may have a role to play, via banks and covered bonds, in financing the renovation gap.

The proposal for an alternative Danish green government bond may be tested soon.

23. Illustration of the Proposed New Green Sovereign Bond by the Danish Central Bank and Ministry of Finance

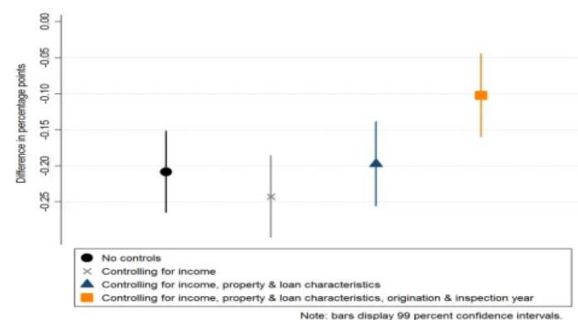


Source: Danmarks Nationalbank.

- The Danish proposal for a green bond is similar to traditional green bonds but with the ability to strip the green certificate and trade it separately in the secondary market (which would have its own ISIN).
- This would address liquidity concerns as the green bond would in essence be a regular government bond.
- BNP Paribas, Danske Bank and Nordea are advisors to the government and a decision may be announced soon.

The Initiative is based on findings that show lower default rates in mortgages on high energy efficiency buildings.

25. Difference in Mortgage Arrears (High vs. Low Energy Efficiency)



Source: Bank of England Staff Working Paper No. 852

- Findings that high energy efficiency in buildings is associated with lower default rates (through increasing property value and lowering energy costs) are the basis for the Energy Efficient Mortgage action plan (BoE 2020).
- Based on this, the initiative advocates for lower risk weights on qualifying mortgages.
- On the basis of a lower capital charge, banks providing energy efficient mortgages could offer preferential interest rates in return for measurable energy efficient improvement in the mortgaged property.

IMF ESG Monitor

- Environmental, social and governance (ESG) considerations are being increasingly integrated in the decision-making of lenders, investors and firms. This is largely driven by rising concerns about climate-related *physical risks* (losses as climate-related changes disrupt economic activity and destroy capital) as well as growing awareness of *transition risks* (the potential for losses resulting from a shift toward a lower-carbon economy).
- The ESG Monitor discusses the role of ESG factors in financial markets covers global developments in sustainable finance, and provides periodic updates on ESG issuance, asset price performance, and ongoing policy initiatives that affect the private sector perception of ESG-related risks.

Glossary of Frequent Terms in Sustainable Finance in This Issue

ESG	Environmental, Social and Governance
ETS	Emissions Trading System (related to carbon emissions)
NGFS	Network (of Central Banks and Supervisors) for Greening the Financial System
PRI	Principles for Responsible Investment (UN-supported network of investors)
SRI	Sustainable, Responsible and Impact Investing
TCFD	Task Force on Climate-related Financial Disclosures

Endnote: Sustainable and Responsible Impact Investing Strategies

Impact and underperformance concerns have led the evolution of ESG strategies from exclusions to more selective inclusion and investor activism. Initially, sustainable investing was primarily about negative screening strategies that excluded firms or entire sectors from investment portfolios. Over time, concerns about risk management, benchmark underperformance, and a need to demonstrate material ultimate impact have given rise to strategies based on positive screening for companies with good ESG performance (best-in-class, improvement), companies that fulfill certain minimum standards or norms (norm-based screening), or sectors that are considered sustainable (sustainability-themed investments). For more information see Chapter 6 of the October 2019 *Global Financial Stability Report*.