Progress with drafting an Issues Note on ESG and green financial instruments

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What this presentation will cover

- The process
  - What has been agreed so far
  - Next steps
- Working definitions in WS.12
- Developing the definitions further in the Issues Note
- Questions for AEG members

The process

What has been agreed so far

- In March 2023, the AEG agreed to a proposal to report Environment, Social and Governance (ESG) and green financial instruments separately as '*of which*' lines in the financial accounts and balance sheets

- The proposal was part of the Well-being and Sustainability Guidance Note *WS.12: Environmental Classifications*, which has now been endorsed

- WS.12 presented working definitions for ESG and green financial instruments, which were to be reviewed and updated in consultation with the third Data Gaps Initiative Recommendation 4 (DGI-3 Rec.4) task team and others

AF	Financial assets and liabilities
AF.1	Monetary gold and SDRs
AF.2	Currency and deposits
AF.3	Debt securities
	Of which: ESG bonds
	Of which: Green bonds
AF.4	Loans
	Of which: ESG loans
	Of which: Green loans
AF.5	Equity and investment fund shares
AF.51	Equity
	Of which: ESG equity
	Of which: Green equity
AF.52	Investment fund shares
	Of which: ESG investment fund shares
	Of which: Green investment fund shares
AF.6	Insurance, pension and standardized guarantee schemes
AF.7	Financial derivatives and employee stock options
AF.8	Other accounts payable/receivable

What has been agreed so far

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Next steps

- In August, the ISWGNA and Task Team leads agreed that there was a need for an Issues Note to elaborate further the definitions in WS.12
- A drafting team has been established made up of Sarah Barahona (OECD), Jim Tebrake (IMF) and Celestino Giron (ECB)
- An outline of the Issues Note has been produced
- The drafting team is working closely with the DGI-3 Rec.4 task team to align methods and definitions where financial instruments are the same, i.e. bonds and listed shares (incl. discussions at a recent DGI-3 Rec.4 workshop in Cape Town)
- We will seek AEG approval of the issues note in early 2024 – in time for inclusion of the definitions in final version of the Glossary and the updated SNA

Working definitions in WS.12

WS.12 definition: ESG and green debt securities (AF.3)

- ***Of which: ESG bonds*** are negotiable financial instruments serving as evidence of debt in which the use of the bond is restricted to finance or refinance activities or projects that sustain or improve the condition of the environment or society or governance practices. These include green bonds, social bonds, sustainability bonds, sustainability-linked bonds, and governance bonds.

    - ***Of which: Green bonds*** are negotiable financial instruments serving as evidence of debt in which the use of the bond is restricted to finance or refinance activities or projects that sustain or improve the condition of the environment.

WS.12 definition: ESG and green loans (AF.4)

- ***Of which: ESG loans*** are funds lent by creditors to debtors in which the debtor agrees to restrict the use of the funds (in whole or in part) to finance or refinance activities or projects that sustain or improve the condition of the environment or society or governance practices. These include green loans, social loans, sustainability loans, governance loans.
  - ***Of which: Green loans*** are funds lent by creditors to debtors in which the debtor agrees to restrict the use of the funds (in whole or in part) to finance or refinance activities or projects that sustain or improve the condition of the environment.

WS.12 definition: ESG and green equity (AF.51)

- ***Of which:* ESG equity** are equity investments by creditors to institutional units who agree to restrict the use of the funds (in whole or in part) to finance or refinance activities or projects that sustain or improve the condition of the environment or society or governance practices. These include green equity and social equity and governance equity.
  - ***Of which:* Green equity** are equity investments by creditors to institutional units who agree to restrict the use of the funds (in whole or in part) to finance or refinance activities or projects that sustain or improve the condition of the environment.

WS.12 definition: ESG and green investment fund shares (AF.52)

- *Of which:* **ESG investment funds** are collective investment schemes that raise funds by issuing shares or units to the public. The proceeds are invested predominantly in whole or in part to finance or refinance activities or projects that sustain or improve the condition of the environment or society or governance practices.

    - *Of which:* **Green investment funds** are collective investment schemes that raise funds by issuing shares or units to the public. The proceeds are invested predominantly (in whole or in part) to finance or refinance activities or projects that sustain or improve the condition of the environment.

Developing the definitions further in the Issues Note

General principles

- **What do we mean by green…**
  1. Positive contribution to the environment?

  or

  2. Do no harm?
- WS.12 proposes the ‘positive contribution to the environment’ principle
- This was also agreed during the DGI-3 Rec.4 workshop with participating countries in Cape Town on 5-6th October
- The Issues Note will recommend ‘positive contribution to the environment’ and elaborate further on what this means

General principles

- **What exactly are we measuring for ESG/greenness?**
- This is not the same for all financial instruments:
  - for **bonds**, we need to look at the financial instrument itself
    - for other debt securities it is not clear
  - for **loans**, it is the debtor (although the data will probably come from the creditor)
  - for **directly held shares** (listed and unlisted), it is the corporation (or the subsidiary if it has a separate listing) and the quasi-corporation in the case of ‘other equity’
  - for **investment fund shares**, it is the fund

General principles

- **On what basis do we measure ESG/greenness?**
- The WS.12 proposal is to use the 'proceeds approach' for all financial instruments, i.e. funds are ring-fenced for a specific green/ESG project
- The current thinking of the drafting team is:
  - For bonds, recommend using a **proceeds** approach
  - For equity and (probably) investment fund shares, recommend using a **revenue** approach, i.e. revenue comes from green/ESG activities
  - For loans, arguments for both **revenue** or **proceeds** bases – still discussing
  - A targets/index approach may also be used in some cases, e.g. for sustainability-linked bonds and for investment funds, but this is seen more as a ***way*** of measuring than a ***basis*** for measuring – still discussing

Taxonomies

- The national accounts are compiled in line with common official definitions and standards to ensure international comparability
- However, there is no international consensus on a classification system or ‘taxonomy’ for ESG/green activities/products/financial instruments/entities
- The taxonomy issue is divisive, with countries adopting different positions
- Therefore, we will recommend that the SNA should **not adopt a single taxonomy** to be used by all countries to define ESG/greenness
    - However, regional versions of the SNA such as the ESA may wish to do so

Certification (labelling)

- Even if the SNA allows the use of different taxonomies by countries, there are choices to be made about the level of certification/labelling required…

1) Does the financial instrument/corporation/fund need to meet an **established standard**? If so:
    a) Must this be an official standard? ***or***
    b) Can it be either an official standard or a private sector standard?

   Private sector standards include the Climate Bonds Initiative, and the International Capital Market Association (ICMA) principles

2) Should we permit self-certification? (i.e. an application is made to one of the standards and approved based on the info provided); ***or***

3) Do we require an external review (e.g. Second Party Opinion)?

The drafting team recommends (1b) and (3) – in line with DGI-3 Rec.4

Thresholds

- **Is a threshold approach useful?**

  Example:

  The principle is established that “to be a green bond, at least 50% of the net proceeds of a bond must be used for green projects”; *and*

  If the threshold is met, then the whole value of the bond is reported as green (the ‘all or nothing’ approach)

- Do you have a view on the level of the threshold e.g. 50%, 60%? Or should we explore further what is used in the markets and in certification processes?
- Do you agree with the ‘all or nothing’ approach?
- **Note**: the threshold approach is often used for bonds, but it may not be applicable for all financial instruments – still discussing

Specific definitions

- The issues note will recommend the following types of debt security to be included in the '*of which*' breakdowns:

  i) green bonds,

  ii) social bonds,

  iii) sustainability bonds,

  iv) sustainability-linked bonds,

  v) Other

  - Only green bonds to be included in '*of which*: green'.
  - Types ii) to v) would be under '*of which*: ESG'.
- While definitions for debt securities are quite well-established, there is still some work to do for loans, equity and investment fund shares
  - DGI-3 Rec.4 is only looking at *listed shares*

Questions for AEG members

Questions

1. Do you agree that the general principle for establishing greenness is positive contribution to the environment rather than do no harm?
2. Do you agree with using the proceeds approach for (most) debt securities and the revenue approach for equity?
3. Do you agree with a flexible approach to taxonomies?
4. Do you agree with our recommendation on certification/labelling?
5. Is a threshold approach useful?
6. Do you agree with the specific definitions proposed for debt securities?
7. Are there any other issues that you think we should be clarifying or addressing in the Issues Note?

THANK YOU

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