

# OECD work streams on sustainable finance and financial markets

**RCE Workshop series on Integrity, Sustainability and Transparency in the Financial System**

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# Outline

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**I. Rise of sustainable finance practices: ESG rating and investing**

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**II. Pricing of climate transition risks in financial markets**

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**III. Net-zero metrics and methodological considerations**

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**IV. Nature-related risks and potential implications for financial markets**

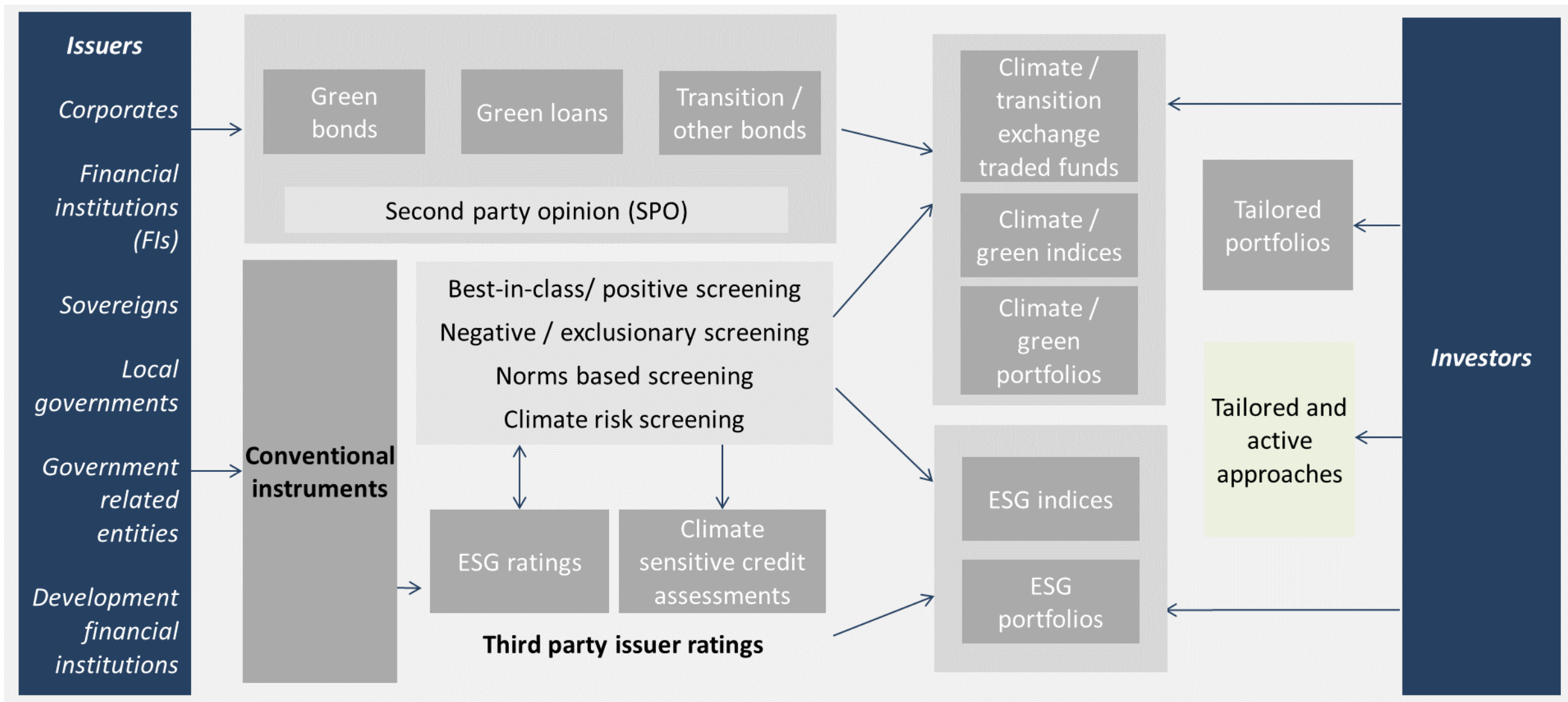
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**V. OECD policy considerations**

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# Financial ecosystem of sustainable finance





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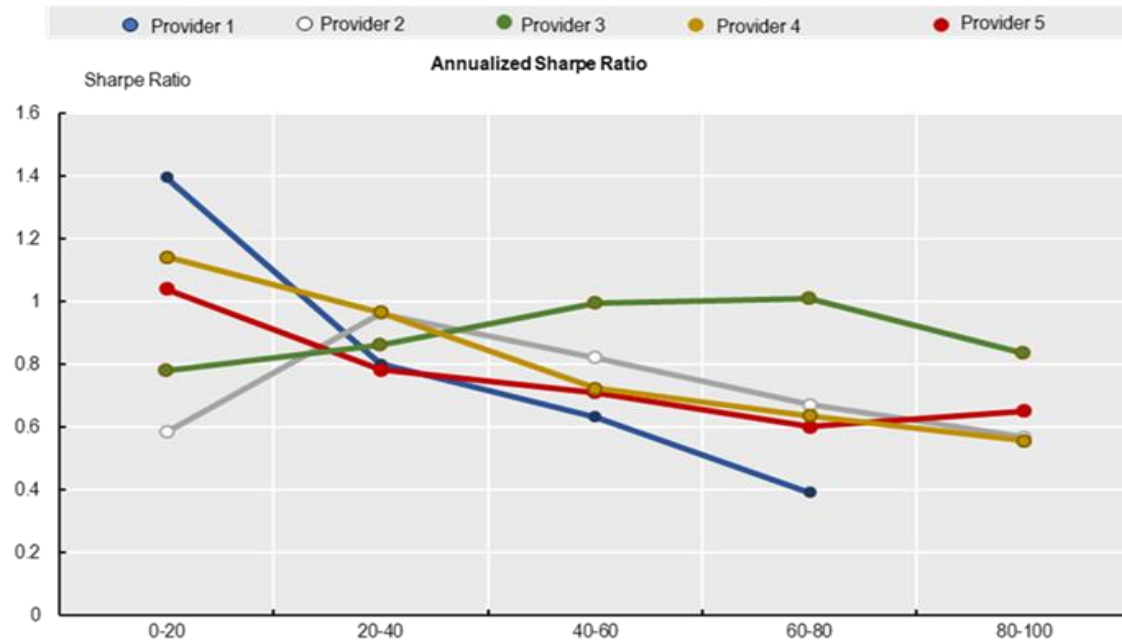
## ESG rating and investing



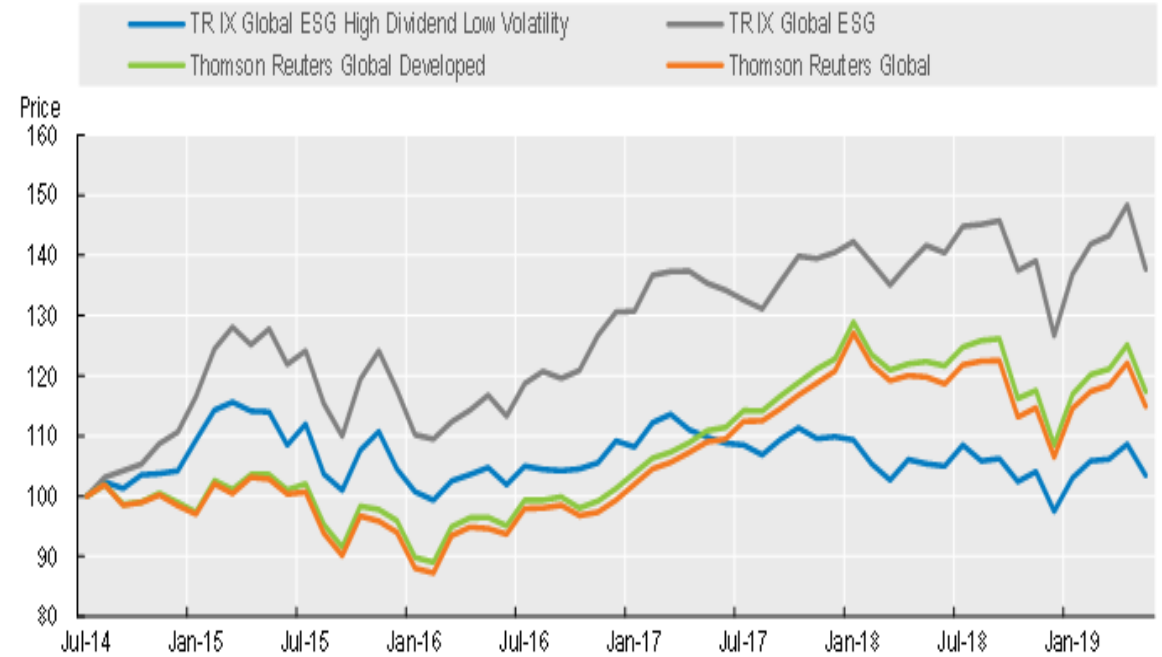
# ESG performance by portfolio and fund returns is mixed

- Investment returns – based on Sharpe ratio of ESG-tilted portfolios and sustainability-rated investment funds– suggest that high ESG collective investments did not perform consistently better than low ESG-rated firms.

### Sharpe ratios of portfolios by ESG scores (world, 2009-19)



### Thomson Reuters Minimum variance frontier and price index with base value 100 (2014-2019)



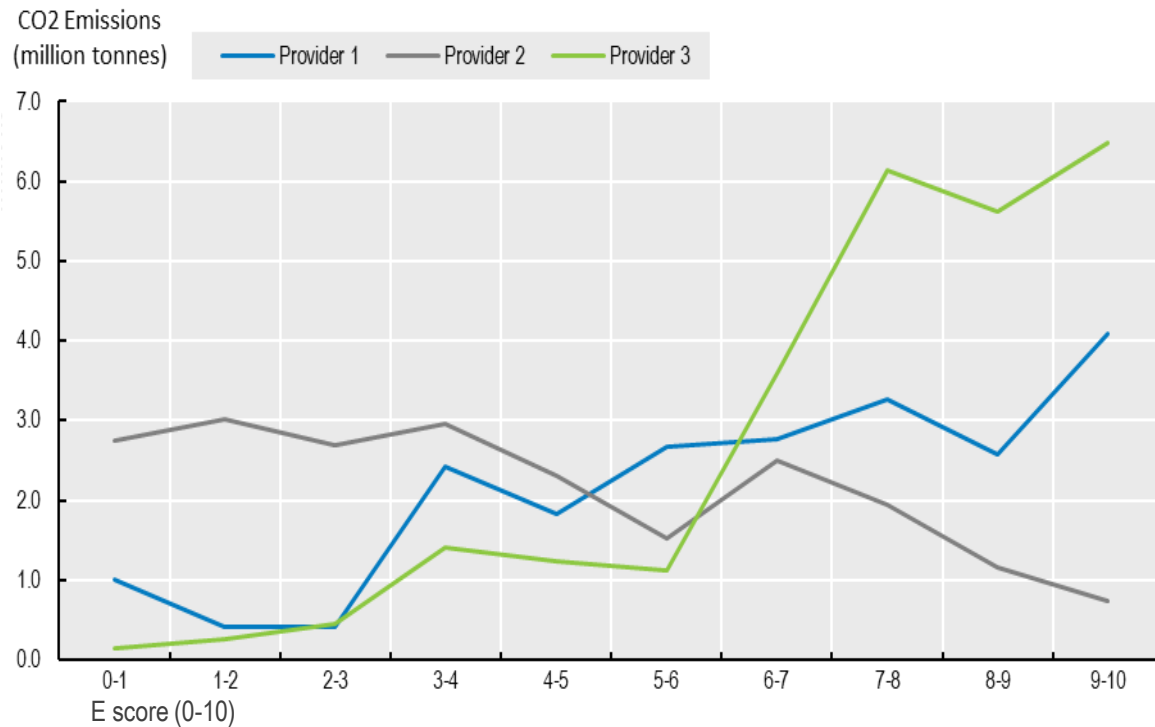
Source: Bloomberg, Fama and French, MSCI, Refinitiv, OECD calculations



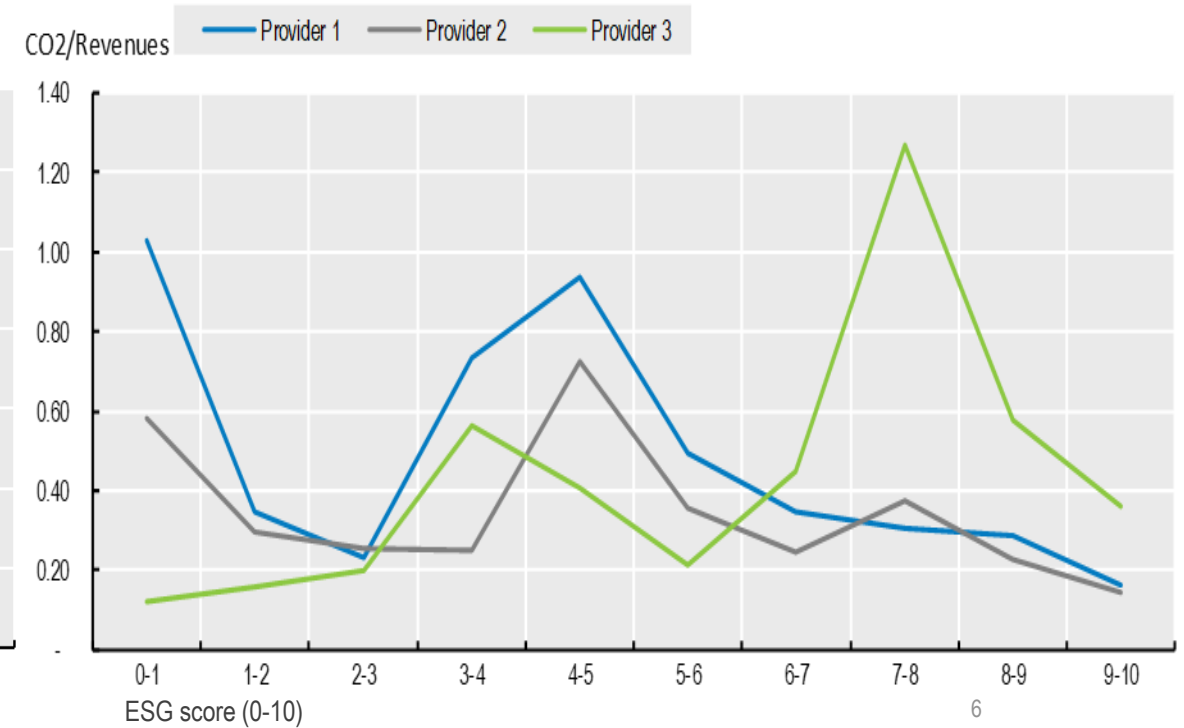
# Higher environmental scores in ESG ratings not aligned with low carbon emissions

- Two providers out of the three analysed show positive correlation between CO2 emissions and the Environmental score, meaning that higher “E” scores can be linked to higher CO2 Emissions.

### CO2 Emission by E pillar scores



### CO2 Emission/Revenue by E pillar scores



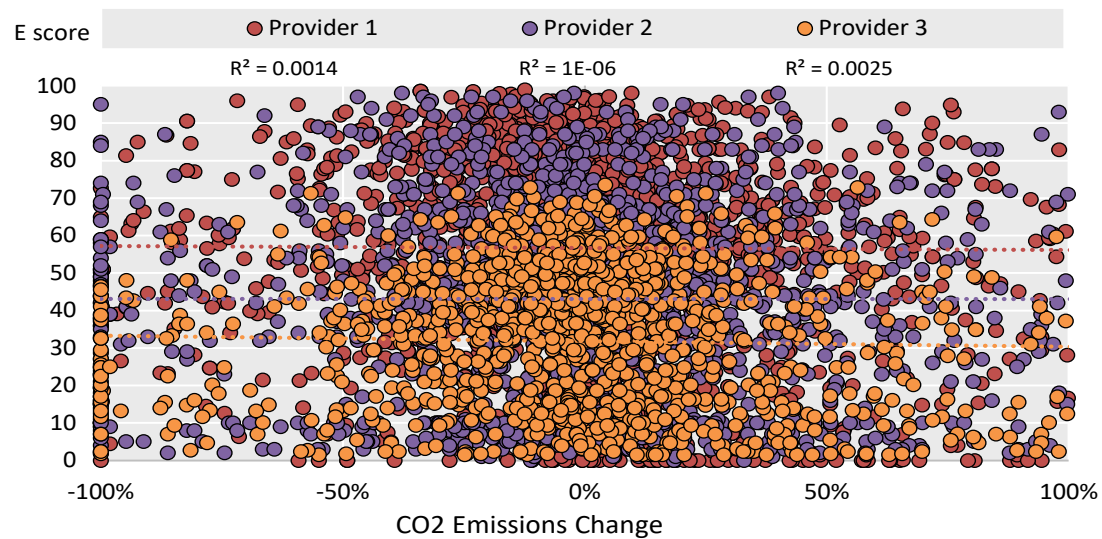
Source: Bloomberg, MSCI, Refinitiv, OECD calculations



# Companies' E scores are not correlated with other climate-related metrics

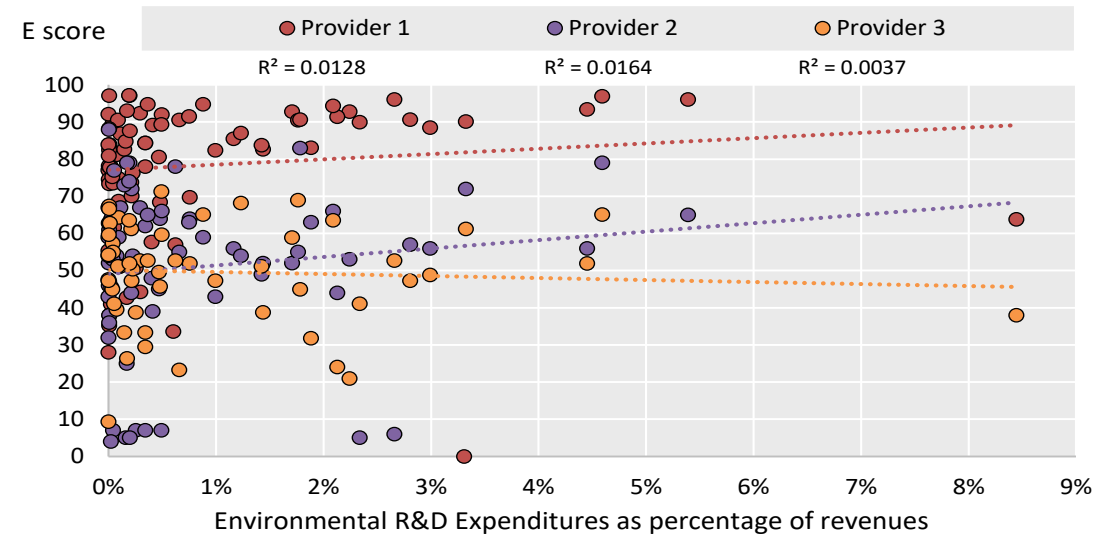
- There appears to be no alignment for the majority of companies analysed between high E pillar scores and the reduction in carbon emissions and carbon intensity over time
- While a smaller set of companies report on environmental Research and Development expenditures, there is no alignment between higher investments and a higher E score

### % change in CO2 emissions by environmental pillar score



Note: CO2 Emissions identified as Total Carbon dioxide (CO2) and CO2 equivalents emission in tonnes, including direct (scope1) + indirect (scope 2)  
Source: Bloomberg, MSCI, Refinitiv, OECD calculations

### Environmental R&D expenditure (% of total revenues) by environmental pillar score



Note: Environmental R&D expenditures calculated as total amount of environmental R&D costs is US dollars (without clean up and remediation costs)  
Source: Bloomberg, MSCI, Refinitiv, OECD calculations



**Pricing of climate transition  
risks in financial markets**

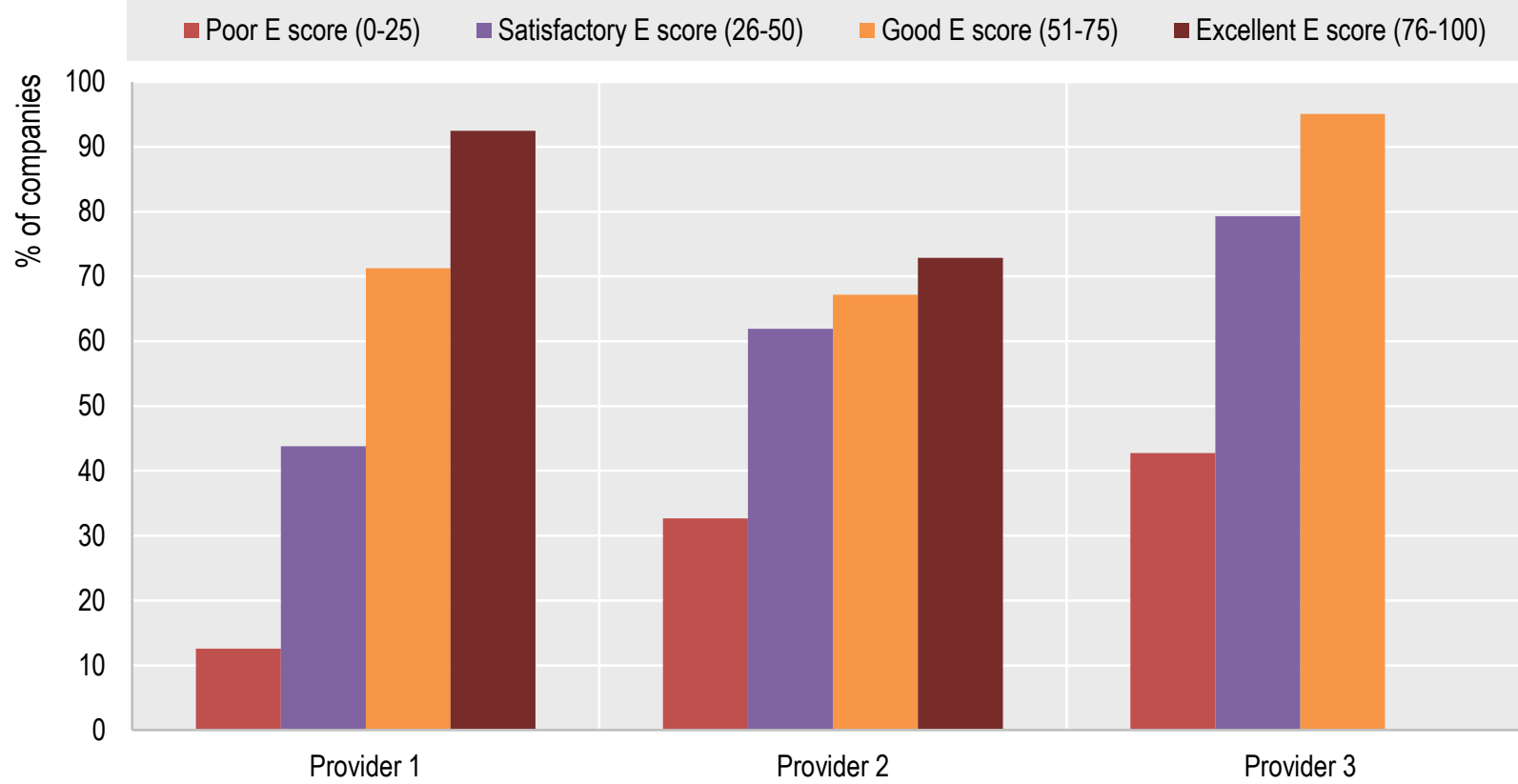




# Companies' E scores are correlated with recognition of risks and opportunities

- Positive → this is forward-looking, so can provide useful perspectives about future actions.
- Negative → based on ambition and disclosure only, and therefore requires active monitoring and engagement.

Share of companies disclosing awareness of climate change risks and



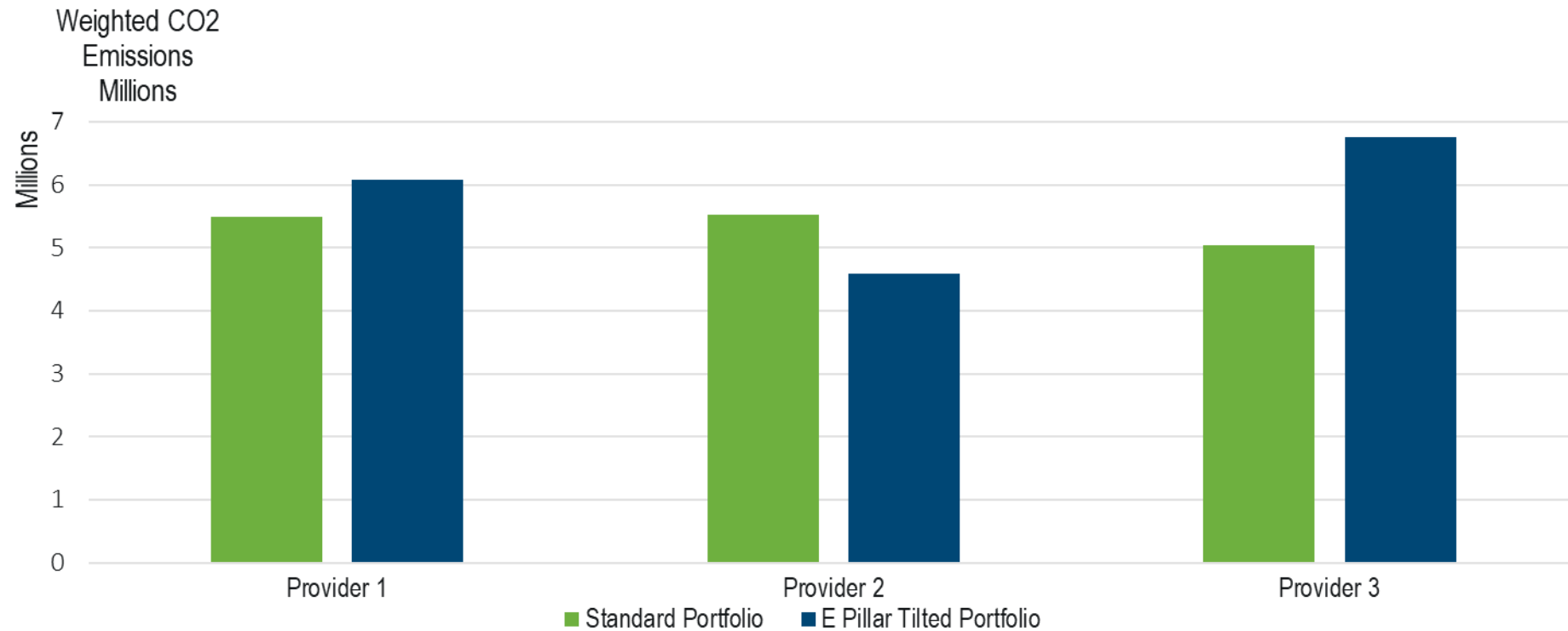
Source: Bloomberg, MSCI, Refinitiv, OECD calculations



# Tilted portfolios can have higher emissions than market-weighted portfolios

- Applying the environmental metrics to a tilting investment strategy, as in these stylized portfolios below, show that in some cases the GHG emissions level actually increases due to tilting.

### CO2 Emission by stylised portfolios



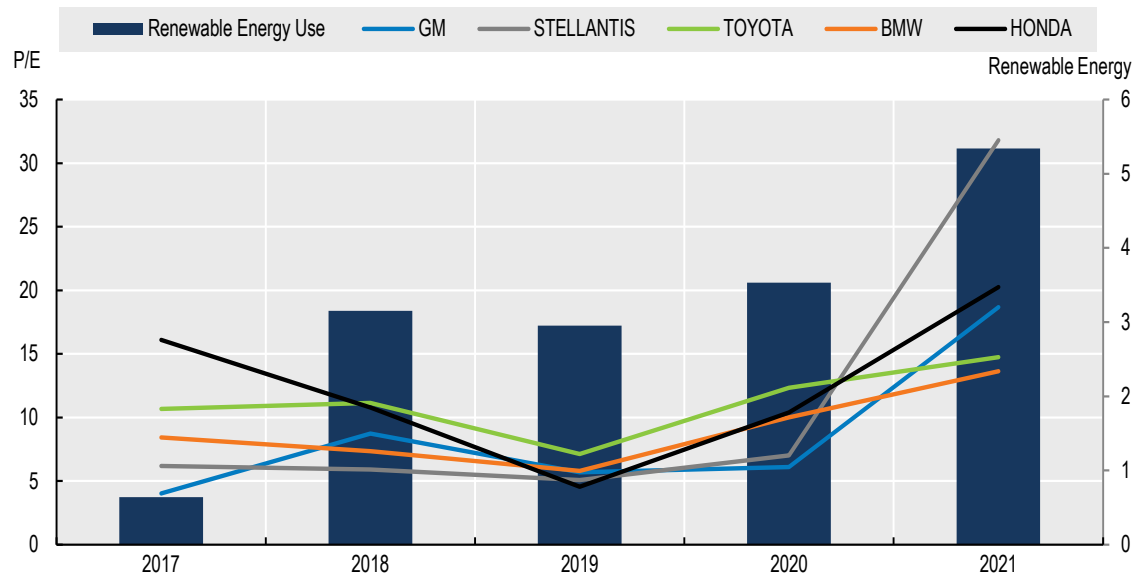
Source: Bloomberg, MSCI, Refinitiv, OECD calculations. Based on Scope 1 and 2 emissions.



# Are financial markets pricing in climate transition?

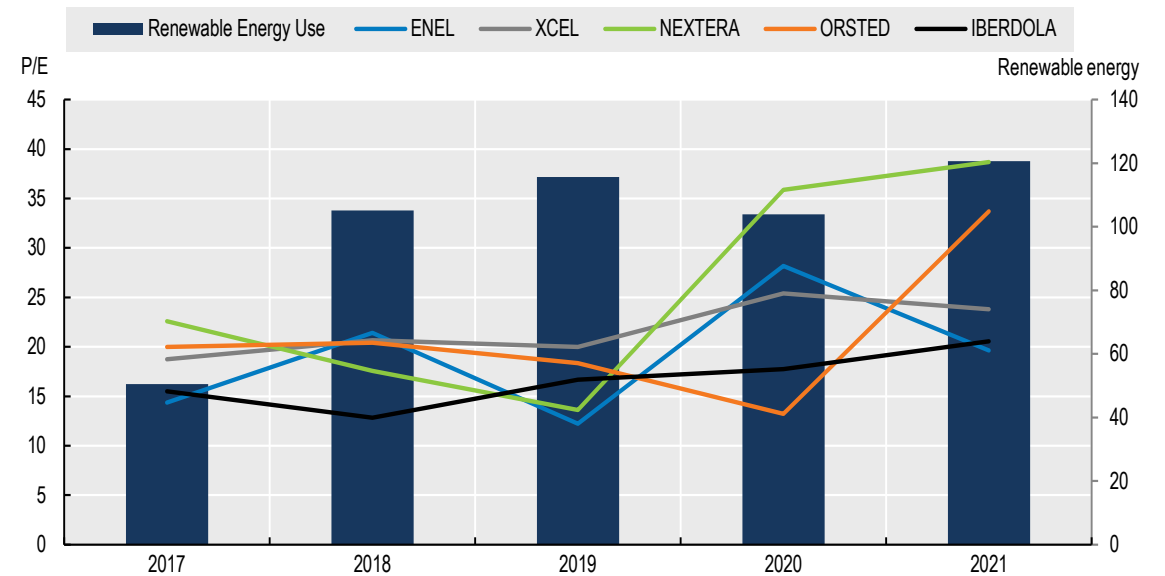
- > Academic and industry analysis offers signs that aspects of climate transition risks and opportunities are starting to be priced into the markets.
- > As per charts below, equity market valuations(P/Es) and industry use of renewables increased sharply in 2021, yet is there sufficient causation?

## Auto companies' P/Es and renewables use



Source: Refinitiv, OECD calculations.

## Electricity companies' P/Es, renewables use



Source: Refinitiv, OECD calculations.



# Several factors impact market valuations related to climate transition risks

## Stranded

- Write-downs on stranded fossil fuel assets
- Write downs on stranded exploration, processing and distribution assets
- Transition risk-related costs
- Unforeseen policy measures on fossil-fuel inputs and use



Impact on market valuations

## Green

INCREASING VALUATIONS



- Price and supply of renewable energy create competitive benefits
- Business transition to renewable energies and energy-efficient processes
- Environmental innovations
- Climate opportunities



REDUCING VALUATIONS



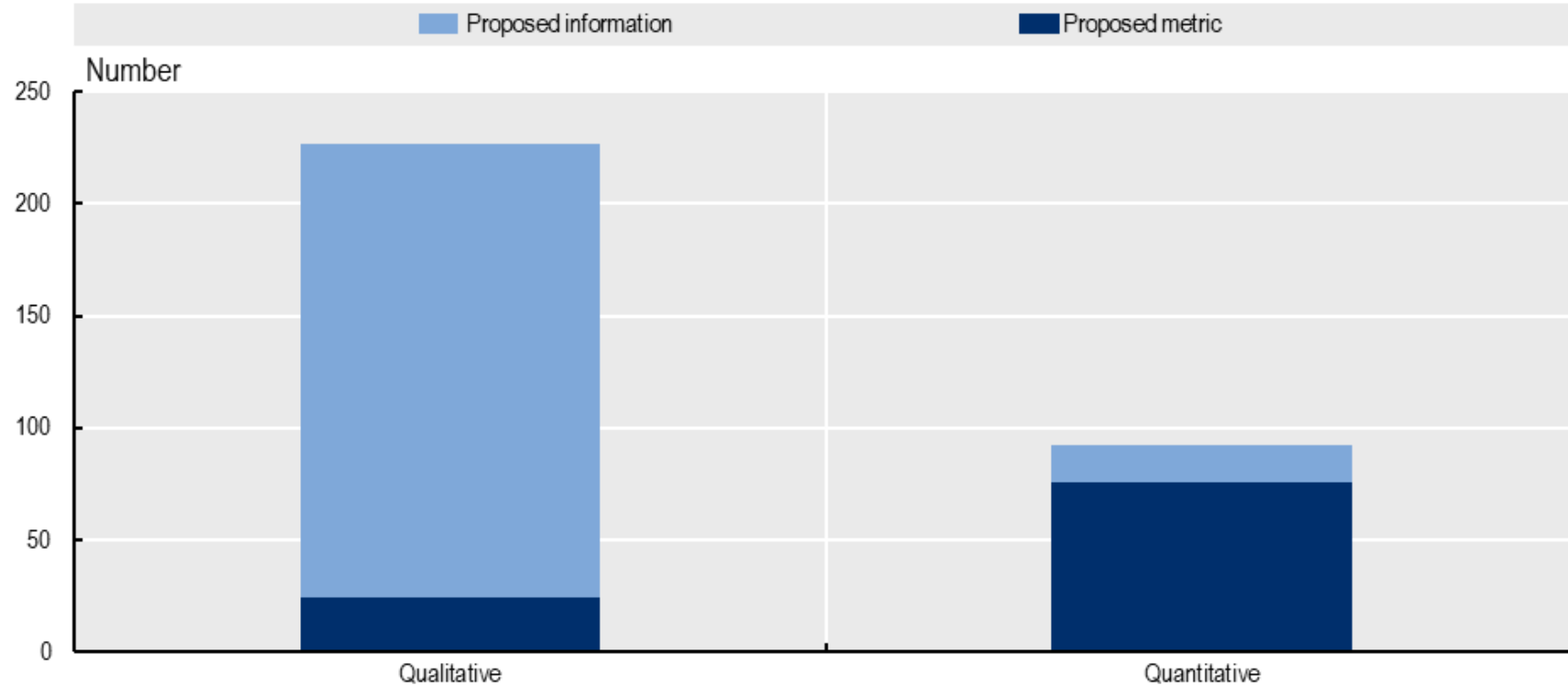
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## **Net-zero metrics and methodological considerations**



# There is an overreliance on qualitative information points over quantitative metrics

*Proposed information points and metrics by frameworks, number by quantitative or qualitative*



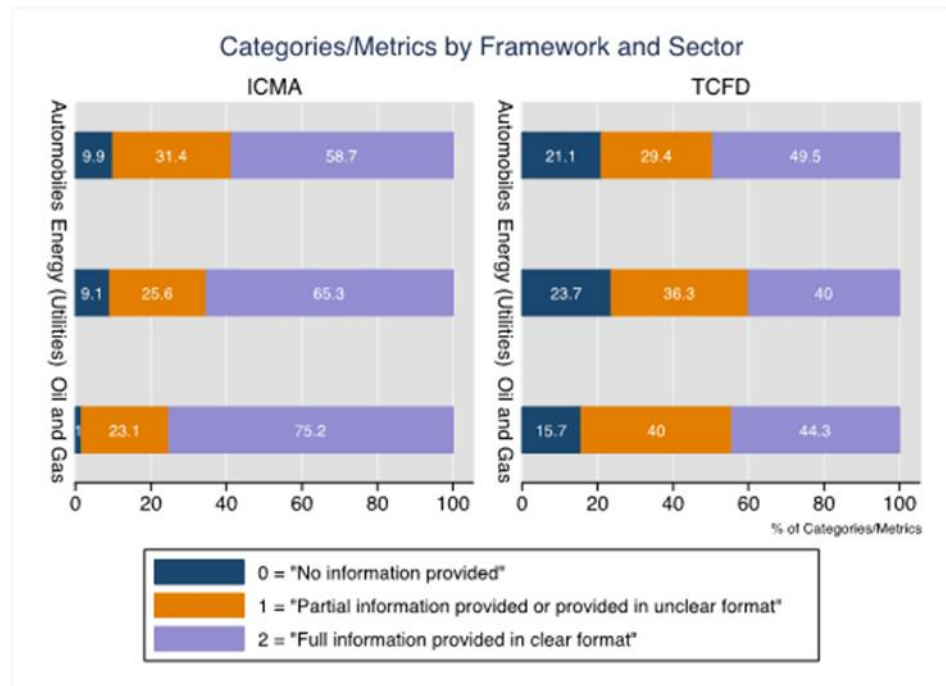
Source: OECD analysis based on public reports from (GFANZ, 2022[5]; IFRS ISSB, 2022[6]; IIGCC, 2021[2]; NZAOA, 2023[4]; TCFD, 2021[3]).



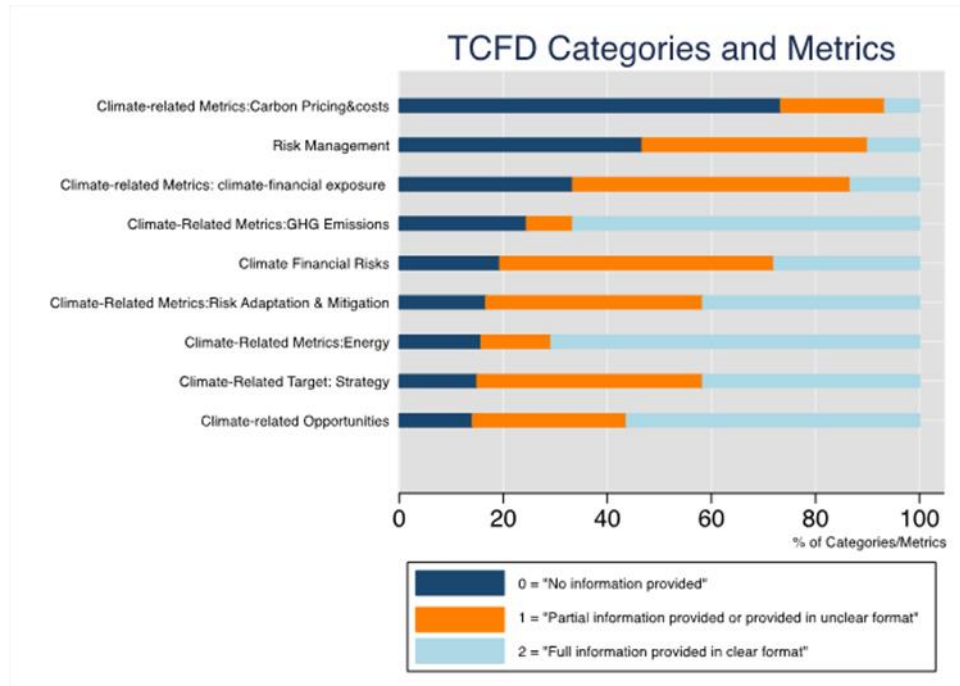
# Alignment of 30 major companies in line with the TCFD framework and ICMA handbook

- While the TCFD framework and ICMA handbook have supported better information included in issuer transition plans, further progress is needed to improve the quality and verifiability of information to signal if a company is likely to effectively manage a low-carbon transition.

## OECD assessment of the completeness of information in transition plans by sector



## OECD classification of the level of information across TCFD framework categories

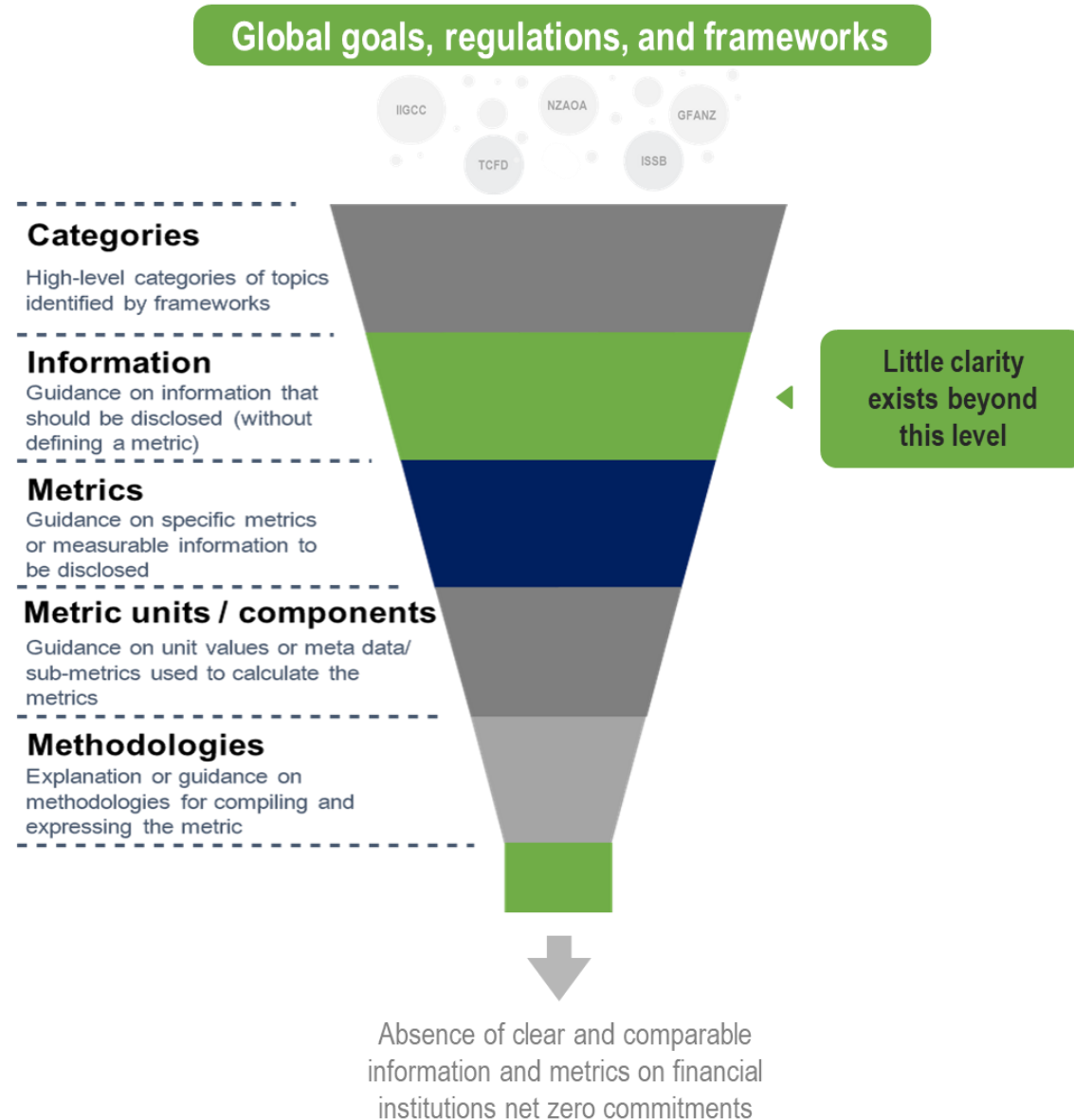


Note: OECD analysis evaluates the extent and accuracy of the data provided in relation to the TCFD and ICMA categories according to this evaluation method: 0 = no information provided; 1 = partial information provided or provided in unclear format; 2 = full information provided in clear format. (See Annex A).

Source: OECD assessment based on TCFD framework and ICMA handbook



# Further guidance is needed to support clear and comparable net-zero metrics







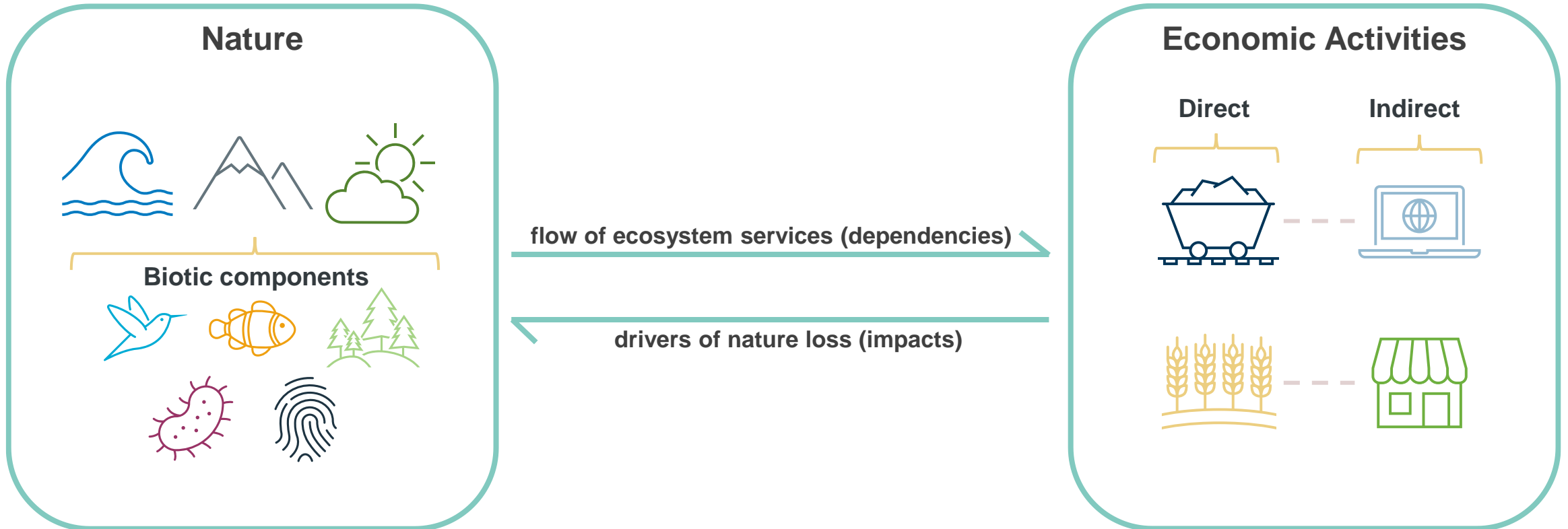
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## **Nature-related risks and potential implications for financial markets**



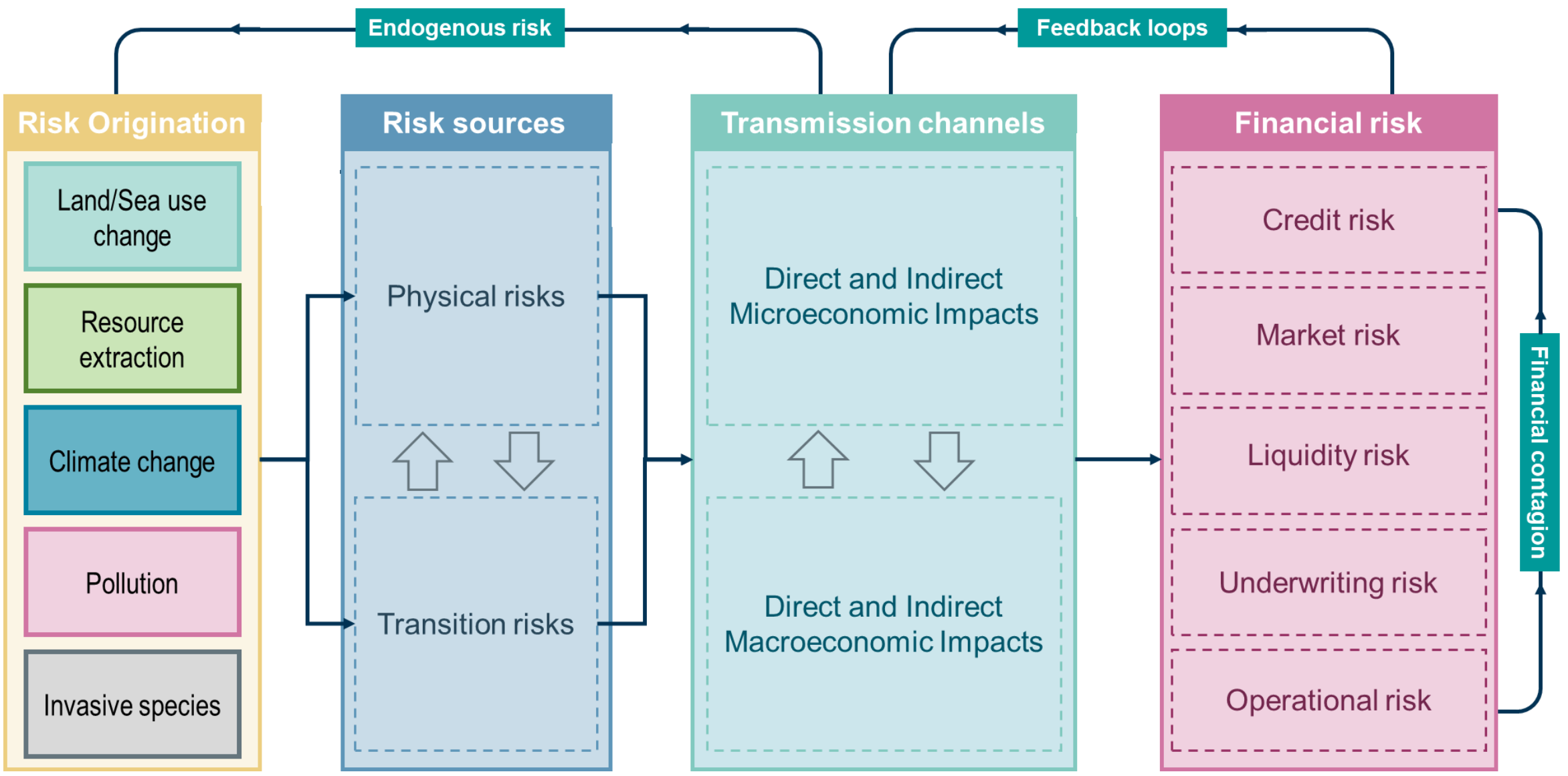
# Interlinkages between nature and the economy

Economic activities in the economy are connected to nature through their dependencies and impacts on ecosystems and the services they provide – either directly or indirectly through their value chain.



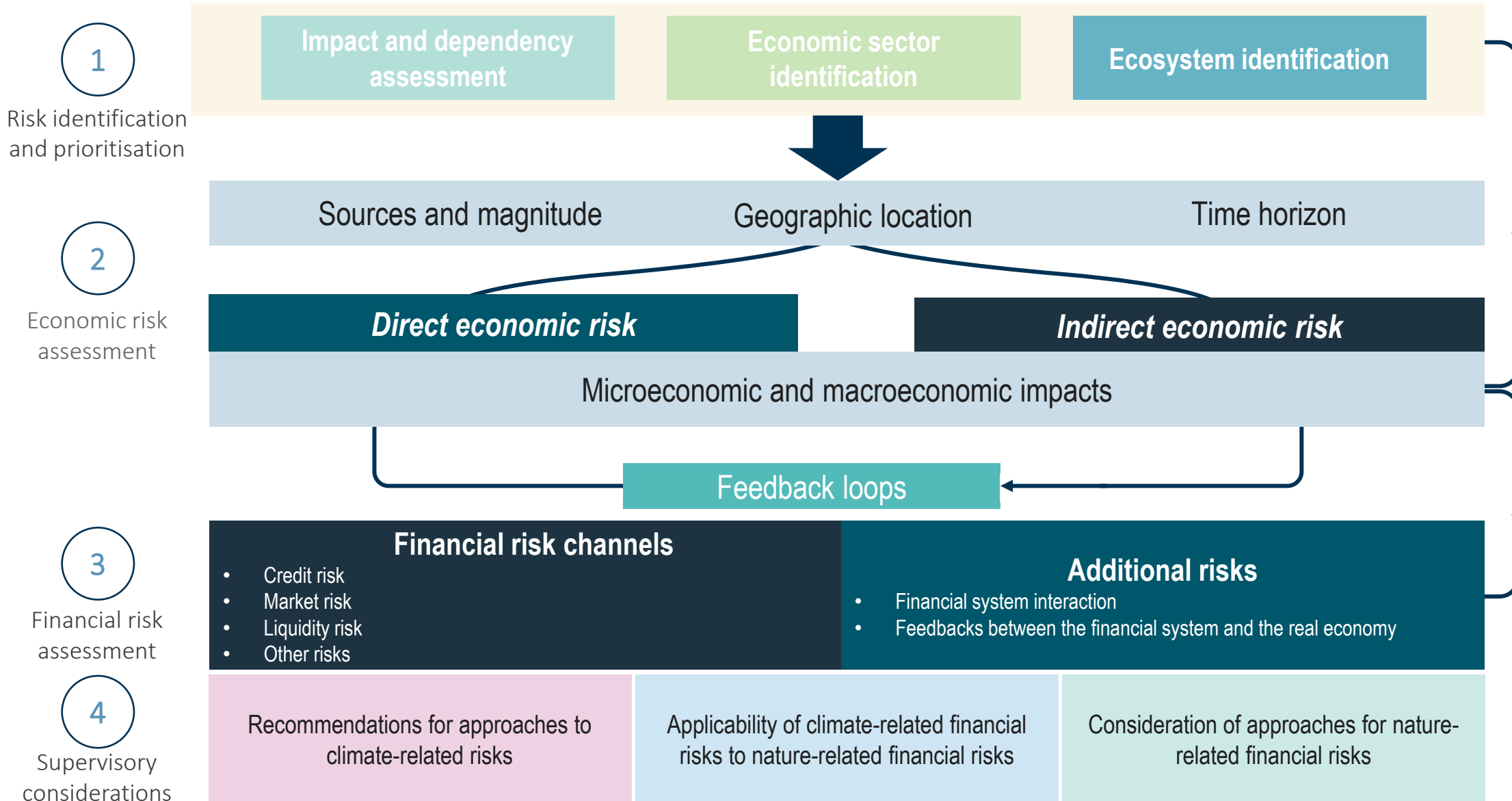


# Conceptual framework of nature-related financial risks





# OECD supervisory framework overview





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## Policy considerations



## Market Practices for ESG Investing

- Strengthen ESG data, metrics, transparency of methodologies, and clarify purpose.

## Market Practices for Climate Transition

- Strengthen climate transition-related data availability and use; science-based targets; verification and investor engagement strategies.

## Good Practices for Central Banks & Financial Authorities

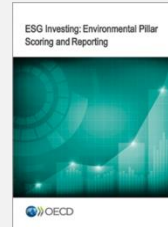
- Good practices in ESG integration, climate-related disclosure, and climate scenarios for stress testing.

➤ *Includes **high-level recommendations**, **sub-recommendations** to strengthen key practices, and emerging **good practices** by central banks, financial authorities, and market participants.*



## OECD Reports

- [OECD Business and Finance Outlook on Sustainable and Resilient Finance](#)
- [ESG Investing and Climate Transition: Practices, Progress and Challenges](#)
- [OECD Policy Guidance to the G20 SFWG on ESG and Climate Transition](#)
- [OECD Assessment of Net-Zero Metrics](#)
- [Responsible Business Conduct](#)
- [Sovereign Borrowing Outlook \(ESG integration and Green Sovereign bonds\)](#)
- [Corporate Governance and Capital Markets](#)



## OECD Content

- Podcasts
- Conference videos
- Summary material of relevant publications
- Infographics on recent work
- Recent data
- OECD standards and good practices relevant to Sustainable Finance (Responsible Business Conduct, Corporate Governance)



## Events

- OECD Tokyo Roundtable: Sustainable Finance Day
- Roundtable on Investment and Sustainable Development