Sustainable Investing and the Role of Securities Regulators

This week's article focuses on the role of the securities regulator in achieving Sustainable Investing and the Financing of the Sustainable Development Goals. This area has important implications for the advancement of the global climate change agenda. Investors with such an investment philosophy will seek to invest in companies and/or projects that will have the greatest impacts on carbon emissions and reducing environmental waste.

Traditional investing delivers value by translating investor capital into investment opportunities that carry risks commensurate with expected returns. The main objective under the traditional investment paradigm is the maximisation of shareholder value. While this should remain an important objective, there is also a recognition that other factors should be considered from a sustainability perspective.

What is Sustainable Investing?

Sustainable Investing is driven by investors and governments wanting to ensure a "greener" future. There is growing evidence that investors are becoming more 'environmentally conscious' in their investments and firms are becoming increasingly aware of this change. One such example is the recent decision by Tesla, Inc. to no longer accept bitcoin payments for the sale of their cars due to the environmental impacts of bitcoin mining. As such, sustainable investing, balances traditional investing with environmental, social, and governance-related (ESG) insights to improve long-term outcomes.

In many ways, sustainable investing can be seen as part of the evolution of investing. There is a growing recognition among industry participants that some ESG factors have long tern economic impacts and it is, therefore, important to incorporate these material factors. **Figure 1** provides a graphic of how investors may possibly evaluate investments using ESG factors. Information for making such evaluations would usually be found within the company's reporting filings such as its Annual Report. Media content on issues such as environmental track record and consumer protection will also play a significant role in such evaluation decisions.

Figure 1 – ESG Investment Evaluation Methodology

Source: Toronto Centre for Financial Supervision

There are three critical elements of sustainable investing:

- It is additive to asset management theory and does not mean a rejection of its foundational concepts.
- It develops deeper insights about how value will be created going forward using ESG considerations.
- It considers diverse stakeholders, consistent with how companies are developing.

The International Organization for Securities Commissions' (IOSCO), of which the Trinidad and Tobago Securities and Exchange Commission ("TTSEC") is a member, developed a report on 'Sustainable Finance and the Role of Securities Regulators and IOSCO'[1] ("the Report") which states that ***sustainability issues*** in general, and ***climate-related issues*** in particular, can raise important challenges in meeting ***core objectives*** in protecting investors, maintaining fair, efficient and transparent markets and reducing systemic risk.

The Report further stated that, "In October 2018, IOSCO established its Sustainable Finance Network (SFN) to provide a forum for members to exchange experiences and gain a better understanding of, and have structured discussions on, various sustainability issues. The SFN has analysed the context in which securities regulators are addressing sustainability efforts, the roles they can play and the challenges they may face. In particular, it has focused on sustainable finance disclosure issues and their relevance for investor decision- making as well as on the development of industry led initiatives".

Sustainable Investing is also inextricably linked to the United Nations' Sustainable Development Goals (SDGs) (see **Figure 2** below). It should be noted that ten (10) out of the seventeen (17) SDGs have a climate-change impact.

[1] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD652.pdf

Figure 2 – Graphic of the United Nations' Sustainable Development Goals

Source: United Nations

Securities Regulators globally are concerned about the many risks that can result from the impacts of climate change. These include:

- **Physical Risk**: This includes the potential for property damage, business disruption, rising expenditures and the threat of legal liability resulting from the failure to mitigate or adapt.
- **Transition Risk:** This involves the likelihood of increased fines and lawsuits for environmental infractions, the possibility of reduced revenues and having to divest. The likely consequence of such divestment exercises would be the presence of "Stranded assets" as a result of having to abandon projects that became economically unfeasible.
- **Investment Risk:** This increases as affected companies experience defaults in their debt as well as steep equity price drops, which will weaken investor confidence in the long-term prospects of the affected companies.
- **Financial Market and Institution Risk:** The cumulative knock-on effects of the three aforementioned risks will be increased investment losses, a reduction in assets under management, increased insurance claims and losses and higher prevalence of household defaults. This would ultimately lead to job losses, economic recession and an uptick in criminal activities.

The SDGs require unprecedented amounts of capital to achieve them. Estimates from the Toronto Centre of Financial Supervision place the required figures to be between US$2 to $4 trillion annually which can be generated via the capital markets. It is widely believed that investors will only invest in projects that provide quality information as a means of managing risk and impact. There is a growing trend internationally that investors not only require financial market stability but also consider the resilience of investments in the face of climate-related challenges. As a consequence, Securities Regulators have been determining the ways

in which these evolving considerations could be incorporated into regulatory requirements. **Figure 3** shows the five main action areas and five supporting actions that Securities Regulators can consider to fulfil such a mandate, as proposed by the United Nations Conference on Trade and Development (UNCTAD).

Figure 3: Securities Regulators' Action Plan on the SDGs

Source: United Nations Conference on Trade and Development (UNCTAD)

Next week, we will look at the steps being taken internationally towards the development and adoption of Sustainable Reporting Standards in support of the aspects concerning sustainable investing.

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