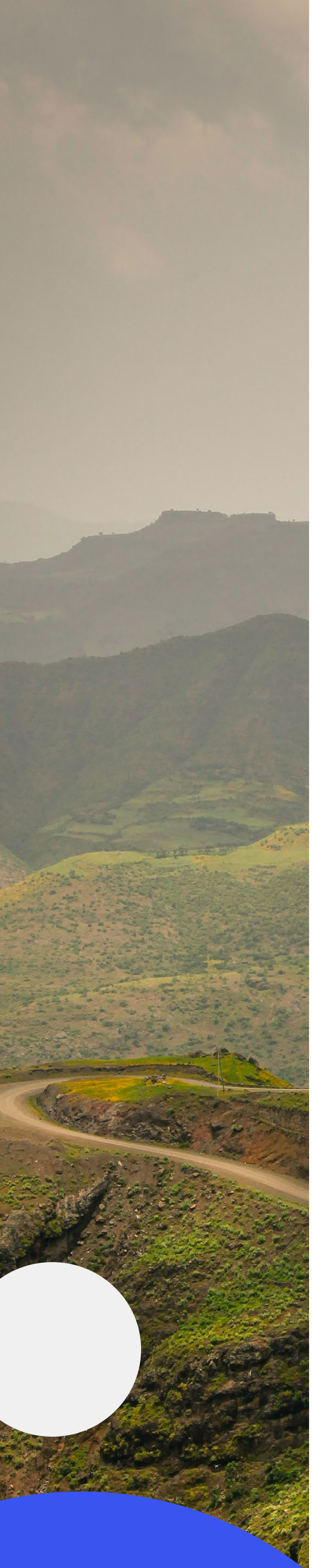
Southern Voice in ESG

Risk and Opportunity Inquiry

November 7, 2022



FOREWORD TO THE REPORT

This report was inspired by a series of conversations between us that were sparked in significant measure by the proceedings at COP26 in 2021, and particularly the launch of the International Sustainability Standards Board (ISSB) by the International Financial Reporting Standards (IFRS) Foundation as an outcome of a previous collaborative effort with the long-running Impact Management Project (IMP). While we generally agreed that these efforts represented positive steps overall and helped to create a significant emerging opportunity landscape, we identified several areas of potential concern that were summarized in this late 2021 **blog** collaboration by the authors of this report.

These initial concerns included prospective issues with divergent priorities between the global 'north' and 'South,' especially around focus on environmental mitigation – or net zero – focus, versus emphasis on adaptation and resilience for vulnerable populations. Additionally, we observed that there could be possible unintended consequences as an outcome of a rush to implement new regulatory frameworks without fuller consideration of the dynamic market realities and experience in the Global South, with potential to generate significant risk as well as potential unintended consequences for all concerned. These discussions generated a broader conversation and ultimately led to this initial inquiry, aimed at bringing greater real-world perspective—in short, the voices—from leaders of Global South financial institutions themselves into the debate.

CREDITS

This project was commissioned and financed by the Dutch development bank FMO, and by the Swiss Capacity Building Facility (SCBF). The views expressed in this report are purely those of the authors and may not in any circumstances be regarded as stating an official position of FMO and/or SCBF.

The principal authors are David Porteous and Jesse Fripp. We are especially thankful for the close and open collaboration with Carolina Benavides-Piaggio of FMO and Sitara Merchant of SCBF, which made this inquiry possible.

We would like to also thank the dozens of participants in the inquiry process, in particular the 32 executives from the Global South financial institutions that were the primary focus of this effort. In addition, we are grateful for the collaboration with a number of industry partners in the outreach and convening process. These include the Digital Frontier Institute (DFI), the Global Alliance for Banking on Values (GABV), the Center for Financial Inclusion (CFI), and numerous leaders focused on the issues of concern to this inquiry who generously shared their time, insights, and referrals.

Jesse Fripp
Shining Rock Ventures

David Porteous
Integral: Governance Solutions

THIS RESEARCH WAS SUPPORTED BY:

FMO Entrepreneurial Development Bank

SCBF Innovating Financial Inclusion

I.

EXECUTIVE SUMMARY

"[The development of international frameworks] is a positive development because we need significant movement building toward the role of business in society: if we're to have any hope of achieving SDG goals, we're going to need business and capital markets to significantly play a role in achieving those. These frameworks are the only way to create movement which brings the majority of significant players into the sphere where we can have these debates."

- Nicola Galombik, Executive Director Yellowwoods Holdings

Environmental, Social and Governance (or ESG) frameworks are intended to provide standards and guidance for how companies should integrate the consideration of risks and opportunities arising from environmental, social and governance factors into their practices at all levels. **But could the implementation of the frameworks themselves be a source of risk OR opportunity for companies?** We set out to explore this question in a well-defined subset of companies: financial institutions operating in the 'global South', that is, in emerging markets and developing economies.

The balance of risk or opportunity is core to this inquiry, and was consistently a part of the engagement process. To date, most international ESG frameworks have been developed mainly under northern leadership and pressure, reflecting the environmental and social priorities of these countries. This is quite different from earlier moves in areas of impact finance like modern microfinance which was 'born' in the global South and whose leading early practitioners like Grameen Bank's Mohammed Yunus, BRAC's Fazle Abed or Bancosol's Pancho Otero were outspoken social entrepreneurs living and working there.

Such early experience has informed such initiatives as the Sustainable Development Goals, which are not directly integrated into most ESG frameworks, but have distinct correlation as we describe later in this report. From the perspective of driving greater focus on positive, long-term outcomes that benefit the world's most vulnerable and excluded communities, it is important to acknowledge that the current focus on investment and regulation that can enable this to happen could be of great benefit to Global South[1] financial institutions and their clients.

On the risk side, there is the concern that in the rush to respond to the climate crisis and global commitments, ESG frameworks become defined without consideration of the realities and perspectives of those affected by the resultant outcomes in the Global South. While we recognize the importance and benefits of the compliance and risk management focus that currently defines much of the discussion around ESG standards, we also consider that the primary beneficiaries of this focus are likely to be public market investors and developed market depositors, given that a consistent emphasis of these approaches is on negative screens and avoidance of perceived risk. As we have observed from the practical effects of implementing other global standards (such as the IFRS 9 and 16), the impact in emerging market environments can inadvertently result in a withdrawal of investment focus from those areas that arguably may most need it - such as emerging technology innovation for climate resilience on one hand, and vulnerable populations on the other - often because they can become classified as 'high risk' or out of compliance with the new standards in various ways that were not necessarily intended by the standard developers.

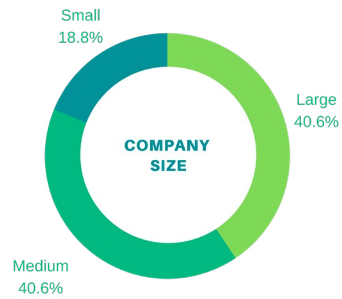
[1] Generally defined for the purposes of this report as emerging and frontier, low to moderate income markets

32 Financial Institutions

As part of our inquiry, we have engaged with leaders from 32 financial institutions, including banks, fintechs, non-bank and microfinance institutions with a fairly even spread among them. They represented institutions of different scale–around two fifths large, with over a million current clients, while a fifth were small with less than 50 000 clients.

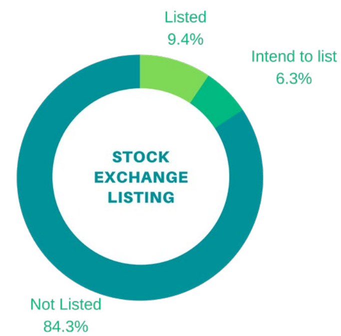
FI SIZE

LARGE	13 COMPANIES
MEDIUM	13 COMPANIES
SMALL	6 COMPANIES



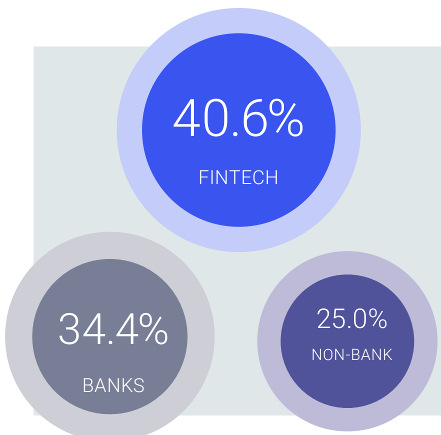
STOCK EXCHANGE LISTING

LISTED	3 COMPANIES
INTEND	2 COMPANIES
NOT LISTED	27 COMPANIES



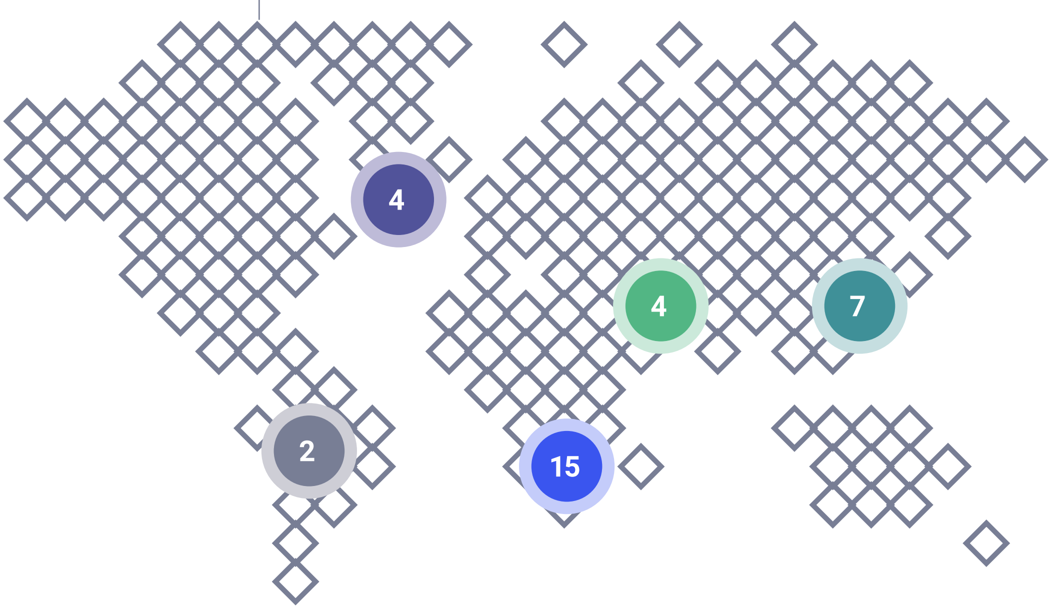
FI REGION

SSA	46.9%
ASIA	21.9%
MENA	12.5%
OTHER (EU/US BASED)	12.5%
LAC	6.3%



FI TYPE

FINTECH	13 COMPANIES
BANKS	11 COMPANIES
NON-BANK MFI/OTHER	8 COMPANIES



SURVEYS COMPLETED	38
WEBINARS HELD DIGITAL FRONTIER INSTITUTE, GABV, FINANCIAL INCLUSION WEEK	3
TOTAL WEBINAR ATTENDEES	156
DIRECT FI INTERVIEWS	32

A consistent set of high-level insights emerged across technical surveys, webinar interactions and one-on-one interviews with these executives that include the following:

- There is a general consensus that **ESG standards and frameworks are increasingly important**, primarily driven by international investors thus far – though even here there is not strong consistency among even ostensibly similarly-oriented (i.e., impact-focused) investors;

- **Larger, especially listed, commercial banks have stronger capacity to fulfil the ESG compliance requirements than do smaller banks**, though they still show gaps in understanding and readiness to manage risk and compliance, as well as identify portfolio opportunity, across the broader emerging ESG space (especially within the 'S-related' or Sustainable Development Goals-oriented universe of standards);

- Respondents indicated a **wide range of views on the question of whether the frameworks constitute more a risk or more an opportunity,** with the median answer close to the middle i.e. they are seen as a true mix of both;

- There is a **consistent gap between levels of self-assessed ESG knowledge, and actual knowledge, based on the brief subject-matter questionnaire;**

- Nearly all respondents are **interested in further learning and knowledge engagement.**

Generally, we found a gap between self-assessed level of knowledge of respondents and their actual knowledge based on a very few relatively simple technical questions. It is unclear as of yet whether this knowledge and awareness gap informs a more positive or more negative outlook around the prospective impact of evolving ESG frameworks.

While the emphasis of the inquiry was deliberately framed around ESG risk **AND** opportunity, institutions differed in their perspectives on which was dominant. For example, larger commercial banks were significantly more focused on the compliance risk aspects of ESG, likely reflecting the increasingly conservative regulatory environment for banks overall with regard to risk and compliance internationally, and a desire to maintain a strong 'defensive' posture.

Given their organizational context and shareholder priorities, 'impact-oriented' regulated banks and microfinance institutions (MFIs) reflected a much greater awareness of and emphasis on reporting related to Sustainable Development Goals (SDGs) and related standards and measures (i.e., the Social Performance Task Force Performance Standards, GABV Scorecard, others). Very often, the nature of this reporting and which standards are being utilized is driven heavily from either an investor or a global institutional holding level, often with limited adaptation to local norms and cultural considerations.

> "We know we have major social impact, we know we have significant [climate] mitigation impact, as well as adaptation and resilience impact. All of these areas are very important to us, as a national impact-oriented enterprise. [Currently]… our international investors rarely request information on this and our national regulator even less so."
>
> *- CEO, major regulated fintech in South Asia*

Finally, leaders of Southern financial institutions consistently prefer incremental approaches to the early adoption of emerging frameworks and metrics. This includes newer emerging areas of consideration and measurement, particularly around climate adaptation and resilience effects for vulnerable populations. Several interviewees noted that the business and regulatory challenges in many emerging markets are such that keeping a primary focus on profitability, and serving the immediate current compliance and risk requirements of regulators and investors, are all that institutions have the capacity to handle on their own.

The possible exception to this perspective comes only from the largest and most well-resourced commercial banks. However, even for them, the global shift over the past two decades toward the primacy of compliance and risk considerations in regulated financial institutions makes it more likely that they may 'wait and see,' and then respond to changing requirements as they emerge. This perspective carries with it an implicit as well as explicit expectation in certain instances that global investors and international and domestic regulators will lead the provision of guidance, and also create the appropriate supporting processes for measured implementation in due course. This is potentially in tension with the sense of urgency expressed elsewhere, including in the recently-issued call to action by the **G7 Impact Taskforce.**

The perceived complexity and lack of coherence and cohesion among emerging standards across the ESG spectrum are also barriers to deciding on how best to engage and advocate around them, certainly at the international level. It is worth noting that, in the example of early movers in the testing of the Task Force on Nature-related Financial Disclosures (TNFD) **framework**, for example, there is a critical tradeoff to early investment of time and effort to be at the forefront of these early conversations. This early investment, in this case, appears to strengthen an early movers position and ability to influence and inform the standards and norms that eventually may emerge.

> "Our anchor investor has incorporated a requirement that we achieve a net-Zero operational footprint as part of our current five-year business plan, and our regulator now considers this in their monitoring of our institutional performance...though our operating environment constrains us practically from accessing the tools and capacities to implement and monitor these requirements fully."
>
> *- CEO of a recently transformed commercial microfinance bank in MENA*

II.

ESG FRAMEWORKS, STANDARDS AND RESPONDENT PERSPECTIVES

Although the acronym ESG signals the three areas of prime focus– namely Environmental, Social and Governance issues–there is no single accepted definition of ESG globally or even locally. Instead, there are now **multiple general frameworks and some specific frameworks which address particular aspects such as climate.** Some frameworks such as the World Economic Forum (WEF) **Stakeholder Capitalism Metrics Initiative** add a fourth pillar of general economic prosperity to ESG. For the purposes of this report, we focused primarily on those encompassed within or considered by the emerging ISSB S1 and S2 frameworks, as well as the WEF, SEC, SFDR, and others we note herein.

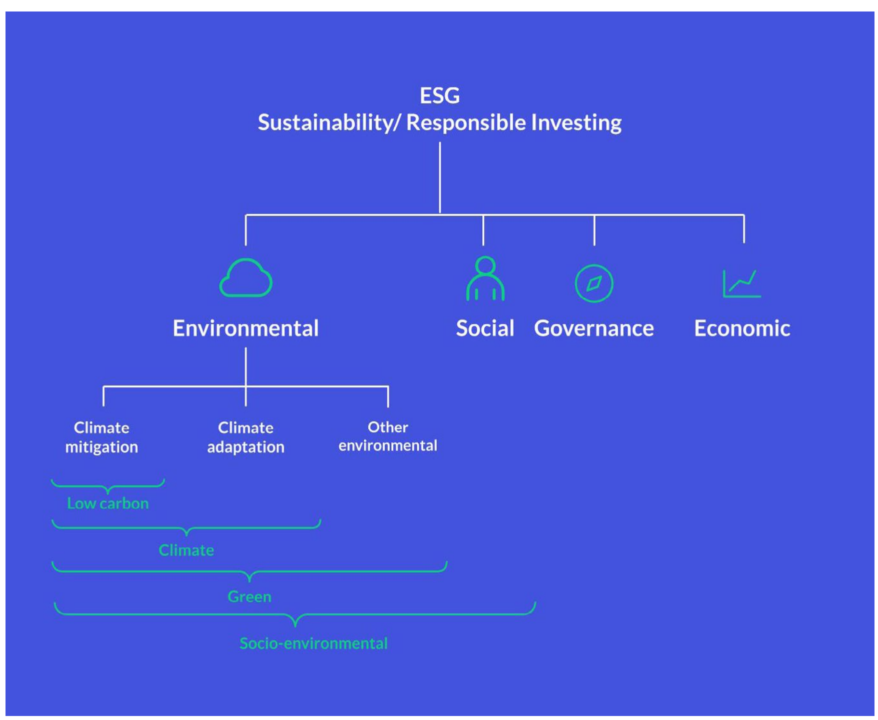
We use the term 'framework' here and throughout this brief generally to refer to a set or sets of principles, guidance, and standards issued usually at an international level, though sometimes also locally. It is at a local level that frameworks may become formalized regulatory norms, or guidance from regulatory bodies which has the force of regulation in effect. Nonetheless, at a conceptual level at least, there appears to be some generally accepted nomenclature as shown in Figure 1.

However, there have been **moves to simplify and converge overlapping frameworks** through the creation of the ISSB in 2021, which published its first set of exposure drafts on **sustainability reporting** and **climate disclosures** in mid-2022; as well as moves to harmonize with the **Global Reporting Initiative**, an independent standards setting body in the area of disclosure. While some respondents in our sample were aware of the IFRS exposure drafts which will likely affect them as financial institutions at a future date, **fewer than 14% of respondents had been engaged in discussion or engagement** around the drafts in their local settings – either by international investors or local market regulators.

In the rest of this report, we step through five observations about these frameworks, seen through the lens of leaders of Southern financial institutions:

1. ESG Investing takes various forms
2. ESG is a growing force globally
3. ESG can be controversial
4. ESG requires new skills and capabilities
5. ESG implications for financial institutions

FIGURE 1: **GENERALLY ACCEPTED NOMENCLATURE**



Source: based on diagram in Sustainable Banking and Finance Report 2021

1. ESG INVESTING TAKES VARIOUS FORMS

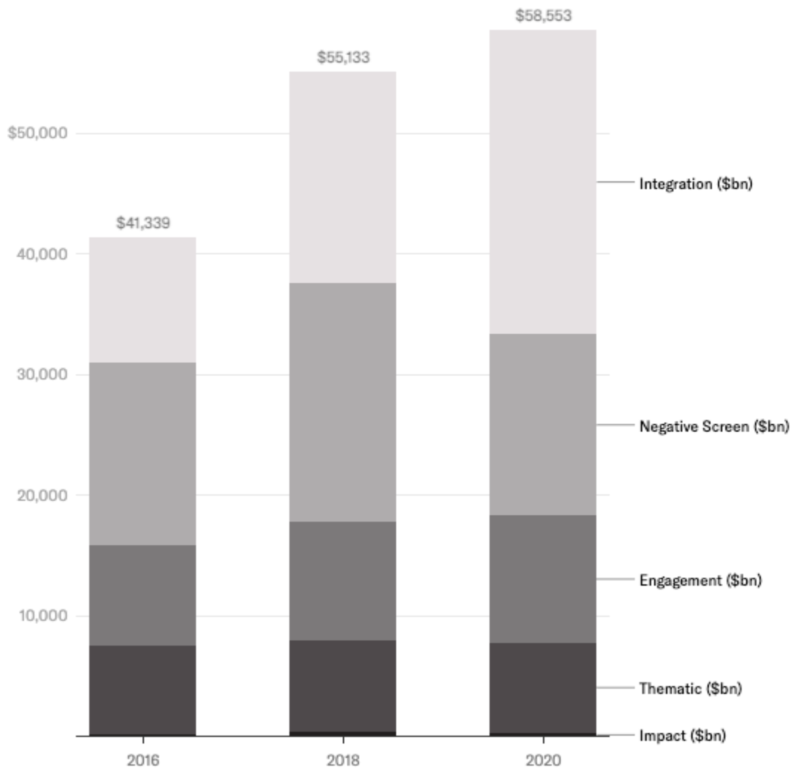
ESG investing comes in various forms, although the definitions are not standardized. The largest categories are public market funds in which investment managers integrate ESG factors or else use them as negative screens in investment decisions. On the other end of the spectrum, impact investors, defined as those who seek demonstrable positive impact alongside financial returns, make up a very small proportion (less than 1%) of ESG funds as shown in Figure 2.

Across this entire spectrum of investment, or sources (where funding originates) and uses (where funds are deployed), differing definitions and frameworks are currently being applied in many cases.

Our sample leaned towards financial institutions with an express concern for positive impact, who were therefore more likely to engage with impact investors and funders. Indeed, a majority reported that their current funders had raised ESG issues with them during the past year.

ESG indicators and standards are not themselves directly linked to SDGs. ESG indicators tend to measure processes or outputs rather than outcomes; whereas SDGs frame a series of globally accepted societal goals for 2030.

FIGURE 2: **ESG INVESTMENTS BY STRATEGY**



Source: ESG and Alpha: Sales or Substance? Institutional Investor 2022 **here.** Total may be overstated due to multiple strategies.

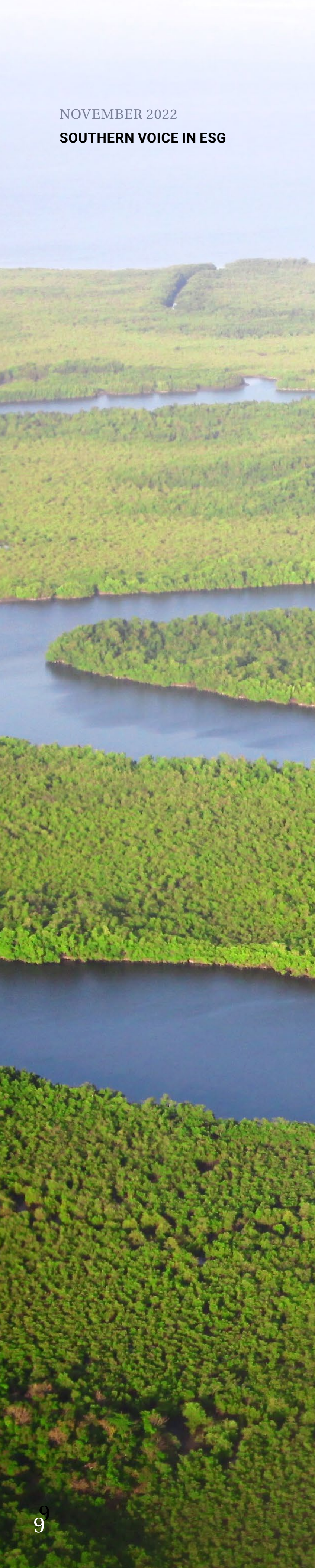


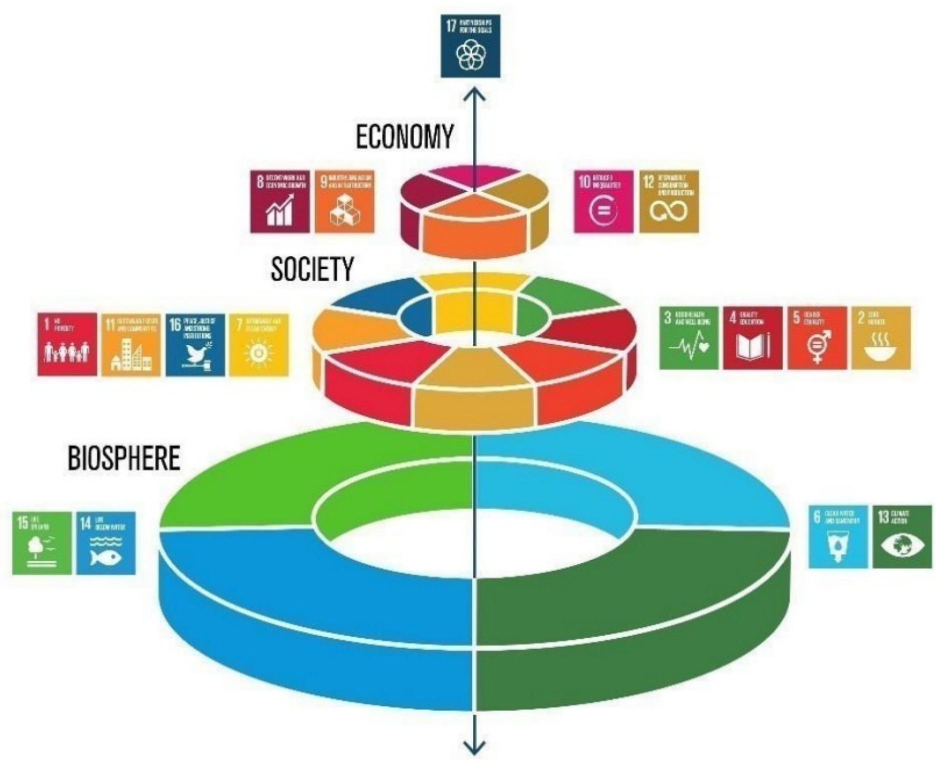
Figure 3 below clusters the 17 SDGs in terms of their outcomes focus, which may be mapped back to concerns for Environmental and Social issues in ESG, with SDG17 relating directly to Governance issues. Some indicator sets such as WEF's (2020) add 'prosperity' as an additional category corresponding to SDG economy-related issues.

The UN Principles for Responsible Investment (**PRI**) was one of the earliest investor frameworks explicitly promoting ESG since its formation in 2006.

PRI has recognized the need to go beyond process standards on ESG to outcome-focused on SDGs: "Ever since the early days of responsible investment, the focus has been on the integration of material environmental, social and governance (ESG) issues into investment policies, decisions and ownership. This has been so successful that we have started to consider responsible investment and ESG integration as equal. The focus of responsible investment has very much been on how ESG factors affect the risk-return profile of investment portfolios and specific investments, but not the other way around i.e., how responsible investment practices support broader objectives of society. In other words, how they contribute to the UN SDGs."[2]

PRI has consistently highlighted that ESG standards applied only for compliance or risk-management purposes may ultimately defeat their original intended purpose as frameworks to measure and incentivize investment with measurably positive outcomes for society. **Of our sample, around a third of the financial institutions said that they currently reported on how their business activities contributed to SDGs, although a further 17% said that they "intended to do so."**

FIGURE 3: CATEGORIZING SDGS BY SUSTAINABILITY



Source: Philippines Sustainable Finance Roadmap (2022) available here

[2] From UN PRI, **Investing with SDG Outcomes (2020)**

2. ESG IS A GROWING FORCE GLOBALLY

Application of various ESG investing frameworks and screens has become a **major force shaping the landscape of investing in developed economies and increasingly also in emerging market economies.** As reflected by the trillions of dollars in assets under management currently captured within the broadest definitions of 'ESG investment,' this is well beyond the very narrow focus traditionally defined by 'impact investing,' which tends to be defined more generally (while not exclusively) by a focus on SDG outcomes. However, as seen through the collaborative evolution of the more impact-investing defined Impact Management Project toward the ISSB, there is convergence happening here as well.

Two underlying trends combine to generate the growing force behind ESG:

1. **Pressure from asset owners like pension funds and institutional investors** who have committed to the application of ESG frameworks like the UN Principles for Responsible Investment since 2006. While this pressure has been focused on public equities and bonds, fund managers increasingly integrate **ESG considerations into alternative investment classes as well.**

2. **Regulatory requirements** in increasing numbers of countries, so far mainly applying to disclosure by listed companies and classes of public entities, or else to investment managers marketing ESG products (as in the EU's Sustainable Finance Disclosure Regulation [SFDR] and US Securities and Exchange Commission's [SEC] proposals). IFRS Exposure Drafts published for comment in 2022 will, when implemented, shape accounting disclosure standards for entities in all jurisdictions which follow IFRS.

This awareness is reflected in the responses to our inquiry. Two thirds of institutions indicated that they view the emerging ESG frameworks to their market and institution as 'very important' or 'important.'

The implications for financial institutions (FI) in the global South include:

(a) National financial authorities (national treasuries and regulators) increasingly require FIs to integrate ESG factors into their disclosure and risk management practices: according to the Sustainable Banking and Finance Network, national regulators in 32 of the 62 country members had adopted national frameworks for ESG Integration by 2021; and the remainder were on a path towards doing so.

Awareness of this increasing pressure was a prominent feature of respondents to our survey outreach, with 82% of respondents indicating that material impact of ESG on their reporting requirements will be 'significant' or 'having an effect' within the next 3 years.

As examples of recent domestic financial guidance cum regulation, see the Central Bank of The Philippines **Circular 1128** or Central Bank of Kenya's **Guidance on climate risk for banks**, both issued in 2021 and now in effect. Financial authorities will also increasingly regulate ESG labeling of financial products to prevent 'greenwashing' as seen in the European **SFDR** (in effect since 2022) and the US SEC **draft** (published for comment in 2022, and currently still open). Countries have increasingly adopted green taxonomies following the European examples, most recently including **South Africa's National Treasury** in April 2022. The **Network for Greening the Financial System**, comprised of 116 member financial regulators from both developed and emerging markets, has also created a **scenario modeling platform** focused on systemic physical and transition risks related to climate change.

(b) International funders will increasingly subject new investments to ESG-related due diligence; and those assessed to be at higher risk will have reduced access to capital markets and funders in developed economies.

While not yet widely applied, certain field-tested applications such as the Global Alliance for Banking on Values (GABV) **Blended Scorecard** approach, or the Social Performance Task Force (SPTF) **Universal Standards for Social and Environmental Performance Management** (SEPM) - which added a seventh standard on environmental impacts in 2022 - may serve as emerging 'good practices.' These and other benchmarks may help to align inclusive finance with ESG norms and standards in measurable ways that could be built upon to bridge the gap between policy-driven ESG frameworks and practice-driven implementing realities within the Global South.

Awareness of this concern is high among respondents, with nearly 55% of institutions indicating that they have 'limited' or 'no' capacity with regard to required levels of skills and/or knowledge in the emerging ESG priority areas.

(c) FIs will have to collect and report more data about their clients and operations. This will have cost and resource implications upfront. However, if the indications are positive, this may pay off in terms of new insights into emerging opportunities within their local market, complemented with potentially greater access to capital at a better price in future.

> "What is the incentive for institutions like ours to make the early investment in preparing for these considerations, especially when the standards and regulatory landscape is still unclear and inconsistent?"
>
> *CEO of major regulated microfinance bank in South Asia*

Work on aligning ESG standards with microfinance - and especially, investing in microfinance - has been occurring since the early 2000's through the efforts of the Consultative Group to Assist the Poor (CGAP), PRI and others. However, the blurring of lines between microfinance and commercial banking, as well as fintech, has led to less clarity and arguably diminished the depth of commitment to SDGs and similar measures in many instances, while opening potential systemic risks with politically-motivated social activism in others. As part of this continuing transformation of microfinance, common regulatory norms such as IFRS 9 and 16 are implictly and explicitly being applied, though often with significant burden on institutional capacity and a shift to a more conservative portfolio risk appetite.

Related to this, other material areas of risk for FIs identified by the **Sustainability Accounting Standards Board** (SASB) include data protection and data privacy. Even if there are yet national laws on the issue, FIs may nevertheless be vulnerable to politically-motivated activism if they do not assess and manage these risks proactively.

This trend also seemed to be reflected by the perceptions of our respondents, of whom nearly two thirds believed that their business activities actively delivered on Sustainable Development Goal (SDG) objectives currently or in the near-term.

(d) FIs can expect more **social activism as ESG standards proliferate**. NGOs as well as investors will hold them accountable to standards they profess, even where these standards may not be fully contextualized to local cultural and other norms and practices. Consider the case of the **Complaint by NGOs to the IFC Compliance Advisor Ombuds** in February 2022 alleging predatory and deceptive lending practices at 6 MFIs/ banks in Cambodia which remains under investigation.

These changing circumstances require careful monitoring. However. just under half of respondents to our inquiry indicated that they currently had a senior manager with designated responsibility for monitoring and oversight of sustainability considerations, either as part of another function or as a dedicated function.

3. ESG CAN BE CONTROVERSIAL

Although widely adopted by institutional investors and financial authorities with a general intention to generate positive outcomes within the areas of consideration, ESG in its broadest sense has become controversial in some places although for a range of different reasons[3]:

- some researchers have **disputed claims that ESG investing produces higher returns in the long run;**
- others are concerned because of the **close association with 'stakeholder capitalism'** which challenges the primacy of shareholder returns as being the main purpose of a company and distracting management from clear focus on delivering bottom-line performance;
- others critique ESG for its own **lack of clarity and even of internal coherence:** there are tensions between E, S and G for example; and the widely differing ESG ratings assigned by agencies suggests a lack of stable or shared criteria;
- yet others are concerned about potential unintended consequences: for example, a 2022 research report interviewing investors indicated that the consideration of ESG factors was leading investors to stay away from higher risk emerging markets as a new form of 'de-risking.'[4]

Our respondents noted the heightened emphasis on particular aspects of the 'E', notably the mitigation of climate risk, instead of on the adaptation and resilience measures that are likely most critical for vulnerable communities concentrated in the Global South. As one respondent put it, "The E has landed, the S is nowhere and the G is hiding somewhere in the other two". Most Southern financial institutions were ill prepared to report on climate risk measures, although they cared deeply about what some called 'the S in the E', that is, the adaptation and resilience indicators among vulnerable populations whom they served, many of whom live in the areas most exposed to the effects of climate change though their own carbon footprints are very small.

However, the controversies around ESG seem to loom less large in the global South. Southern financial institutions overall reported a slightly positive view on ESG, with a mean of 2.7, that is above a neutral 3 on a scale of 1 (fully agree) to 5 (fully disagree) in response to the statement, "ESG frameworks are on balance a positive force for our organization." Notably, bank and regulated fintech respondents were marginally more positive about the likely impact of ESG frameworks than the other groups.

To the more general question, "ESG frameworks are on balance a positive force for our domestic market," the mean response on the same scale was 2.9, just above neutral, though this time more positively led by the perceptions of unregulated fintechs and MFIs. It is possible that these perceptions reflect a generally less politicized current environment around ESG considerations in the global South, as well as a lower

[3] Many of these are summarized in the recent Economist Special Report on ESG Investing, available **here**

[4] Stuart Theobald "Drivers of Investment Flows to Emerging and Frontier Markets" (2022) available **here**

level of general awareness of the current issues affecting ESG investors and regulators in developed markets, both of which could foreseeably change in time.

4. ESG REQUIRES NEW SKILLS AND COMPETENCIES IN FINANCIAL INSTITUTIONS AND REGULATORS

ESG frameworks bring new skills and experience requirements, but these are often missing–even in large, well-resourced companies in the global north. For example, the **PWC 2022 Annual Corporate Directors Survey** of 850 corporate directors [based mainly in the north and at large companies] found that fewer than two-thirds say their board understands the company's climate strategy and risk, as well as related internal processes and controls around data collection. Furthermore, only 45% of respondents recognized a connection between ESG and bottom line performance, a decline of nine points year-on-year – a possible reflection of the understanding disconnect noted prior. In line with this perspective, only 45% of CEO respondents saw a positive perception of the connection between ESG and stronger financial performance, according to the **KPMG 2022 CEO Outlook** [which surveys 1,325 CEOs of medium to large companies across 11 primarily developed markets].

Of note, the PWC Survey indicates that large company boards understand their companies ESG risks at a level of 91% and ESG opportunities at a level of 87%, compared to boards of smaller companies understanding of these same factors at a level of 66% and 61%, respectively. The differentiation between larger FI's and medium and small FI's in our inquiry follows a not dissimilar pattern in this regard, reflecting the likely real capacity constraints in recruiting and/or training boards and management with these skills and experience.

"These gaps between expectations and understanding, and indeed, between investors and boards, open up the risk that the gathering ESG wave crashes on the shores of a compliance only approach."[5] Public companies and all affected by new regulations and standards will have to train and recruit staff to address increasing disclosure requirements from investors and regulators. Prudent compliance or enterprise risk management policies and processes are essential elements of an effective ESG standards framework. However, if these considerations alone dominate how these frameworks are applied, the risks of creating unintended consequences in terms of overall negative outcomes for vulnerable communities in the Global South could be significant.

Among our sample, **two thirds found it very important or important now to have people with skill and knowledge of ESG issues inside their organizations.** The rest said it was not important now, but it was likely to become so in the next five years. However, a majority (56%) reported that current skills levels were lacking ('limited' or 'none'); only two out of 32 institutions responding had self-assessed capacity in this area adequate for their needs.

In addition, looking for those who had a clear and distinct voice on this issue, we asked all respondents to identify leading Southern voices, whether in the financial sector or beyond. However, we received few suggestions. While there clearly is some Southern voice reflected in most if not all of the framework bodies, such as the United Nations Environment Programme Finance Initiative (UNEPFI) or IRFS, **there is less evidence at present of a distinct Southern voice shaping on these issues.** This is especially true for the critical areas of adaptation and resilience of the most climate-vulnerable populations.

In the course of our discussions, **we encountered the view that the impact of ESG frameworks may be asymmetric** less by geography (i.e., whether based in the global north or South) and **more by institutional size**. Small and medium sized institutions have less capacity to hire new skills and may be more affected than large ones, wherever they are based.

Our aim at this stage was not specifically to engage respondents on this beyond what they themselves are currently doing. The possible strategic stance of a financial institution on this issue depends on how material the issue is to them in their local market context. This context will likely vary based on factors like client base, regulator attitude and extent of foreign funding; and the extent to which they believe ESG frameworks are locally influenceable. This will be a function of how much domestic regulators are influenced by international norms, and whether they are open to local adaptation.

[5] Porteous & Fripp "Governance towards Social and Environmental Resilience: Reframing ESG to include perspectives of the Global South" (2021) available **here**.

5. ESG IMPLICATIONS FOR FINANCIAL INSTITUTIONS IN THE GLOBAL SOUTH

> "We haven't really seen [ESG frameworks] as a risk - perhaps an opportunity but certainly an imperative for operating businesses in the zone of tremendous inequality."
>
> *Executive of South African Multinational Investor*

From the perceptions gathered through our inquiry, Southern financial institutions expect the frameworks to have a material effect on them in the next three years; and they currently see themselves as lacking in capacity to address them. As we explored how the frameworks themselves could be risks or opportunities, a list of examples in each category emerged:

Potential Risks:

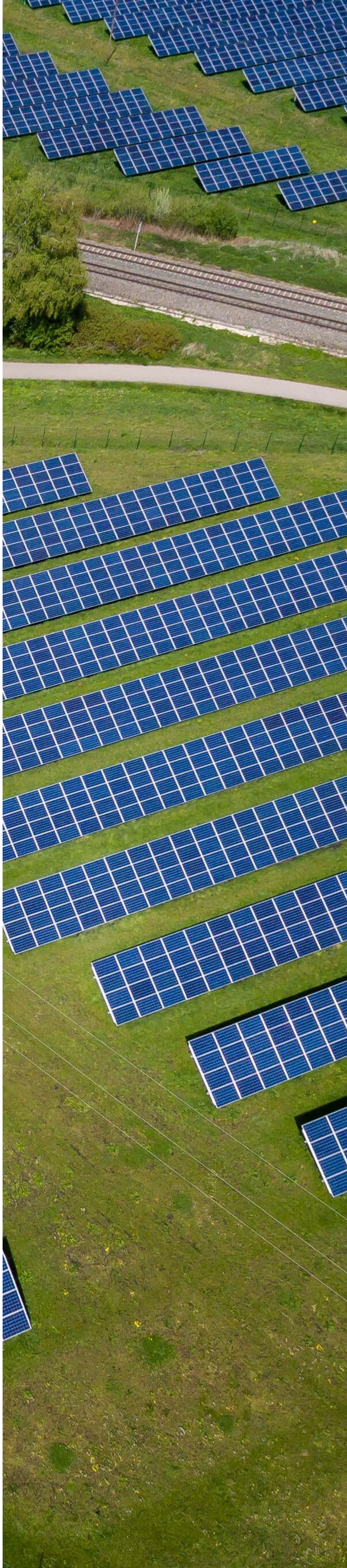
- Diversion of skills and focus from other priorities
- Costly to implement
- Distraction from national priorities [usually defined by regulators]
- Constraining access to capital if not compliant
- Changing nature of impact
- Rapid adoption may be superficial, i.e., ESG-washing of compliance only
- De-risking of portfolios may reduce service access and reach to vulnerable clients, or emerging opportunity areas

Potential Opportunities:

- Accelerating access to new market opportunities
- Informing high impact new product design and delivery
- Creating incentives for transformative new partnership approaches
- Creating brand-new revenue opportunities
- Differentiation from competitors in capital raise
- Differentiation on staffing through proactive focus on capacity-building
- Implementing better developed and capacitated Enterprise Risk Management (ERM) and/or Enterprise Security Risk Management (ESRM) approaches and practices
- Resourcing for new areas of capacity-building
- New funding for new portfolio development

Overall, are the emerging frameworks seen more as risks or as opportunities?

Our sample indicated a mix of both. For example, asked to indicate their level of agreement on a scale of 1 (fully agree) to 5 (fully disagree) with the statement: "ESG frameworks create new reporting burdens which are disproportionate to the likely benefits," responses were very close to neutral at 3.09, with marginal difference between banks and non-banks. Responding to the statement "ESG frameworks encourage us to consider opportunities for value creation more than the need for compliance", responses averaged 2.8, close to the neutral 3 mark. Similarly, "ESG frameworks create new reporting burdens which are disproportionate to the likely benefits" yielded an average of 3.1, again reflecting very marginal disagreement on balance. However, as one respondent told us, "Different frameworks may bring specific risks or opportunities, but overall, we see having an approach to sustainability is an imperative, not a choice."



III.

CONCLUSION AND POTENTIAL WAYS FORWARD

Our engagements with leaders of Southern financial institutions suggest that certain initiatives in these areas below could increase the likelihood of positive impacts from enhanced awareness of and capacity to engage with the emerging ESG frameworks.

The following summary of potential approaches is intended to spark thinking and action, rather than to prescribe a detailed approach.

1. Knowledge-building, including in areas such as,

a) Professional development and certification-level approaches for accelerated roll-out of C-suite level executives with sustainable finance practitioner expertise

b) Intensive awareness and capacity-building at the governance level of financial institutions

c) Exposure of governance and management among leaders of Global South financial institutions to the potential market-shaping impacts of evolving ESG standards through applied insights and field-testing approaches to standard applications

d) Further research and investigation into broader and/or deeper areas of insight from this initial inquiry, including potential further engagement with investors, regulators and policymakers, as well as expanded inquiry with financial institutions

2. Institutional-level proactive action in areas such as,

a) Development of applicable strategy frameworks, risk appetite and management frameworks, compliance framework, audit and control frameworks, as well as updated templates to various operations policies and procedures reflecting emerging ESG practices

b) Development of key C-suite level 'focal point' positions, such as the role of Chief Sustainability Officer (CSO), to build internal momentum, capacity and buy-in to change management processes

c) Development of peer 'communities of practice' for awareness-building, knowledge-sharing, and coordinated engagement with policymakers, investors, regulators and other stakeholder partners,

d) Building of knowledge and insights to 'right-sizing' carbon finance opportunities to retail emerging market financial institutions and investors through proof-of-concept testing and deployment of monetizable measurement and indexing approaches

3. Advocacy and proactive policy-level engagement in areas such as,

a) Trial applications of new benchmarks such as the Task Force on Nature-related Financial Disclosures (TNFD) and Task Force on Climate-related Financial Disclosures (TFCD), engage with policymaking and regulatory stakeholders to 'field test' emerging frameworks and standards prior to rollout at scale in local and regional markets

b) Collaborative approaches between development finance institutional investors, standard-setting and policy-making bodies to inform and harmonize development and application of frameworks and standards that can reflect and prioritize the capacity-building needs of emerging market financial institutions on the front lines of implementation at scale of emerging standards

c) Industry convenings, including roundtables, workshops and alliance-building within existing industry and sector networks and initiatives to accelerate awareness-building, knowledge-sharing and solutions-development in a proactive and holistic fashion

Based on our inquiry, Southern financial institutions clearly believe that international ESG frameworks matter, and that they will affect their activities in some way, negative or positive, in the next three to five years. As the numerous voluntary frameworks converge and start to harden into standards and even local regulation, it is important that Southern financial institutions have voice and can participate meaningfully at all levels.

This will contribute to shaping international frameworks, as well as their regional and local implementation. In the presence of conflicting priorities and constrained internal resources, this will take time. Tempering the potential imperative to 'rush to regulate,' with intentional engagement over time will likely improve outcomes for the financial institutions that are represented in this inquiry, and for the many vulnerable clients they serve.

LIST OF ACRONYMS USED

CGAP	Financial inclusion action group within World Bank Group
CSO	Chief Sustainability Officer
ERMS	Enterprise Risk Measurement System
ESG	Environmental. Social and Governmental factors
FI	Financial Institution
GABV	Global Alliance for Banking on Values
GRI	Global Reporting Initiative
IFRS	International Financial Reporting Standards
ISSB	International Sustainability Standards Board
IMP	Impact Management Project
PRI	Principles of Responsible Investment
SDG	Sustainable Development Goal
SEC	Securities and Exchange Commission (US)
SFDR	Sustainable Finance Disclosure Regulation (EU)
TCFD	Taskforce on Climate-related Financial Disclosures
TNFD	Taskforce on Nature-related Financial Disclosures
UNEP-FI	United Nations Environmental Program—Finance Initiative
UN PRI	United Nations Principles for Responsible Investment
WEF	World Economic Forum

REPORT ANNEX

ESG Attitudes

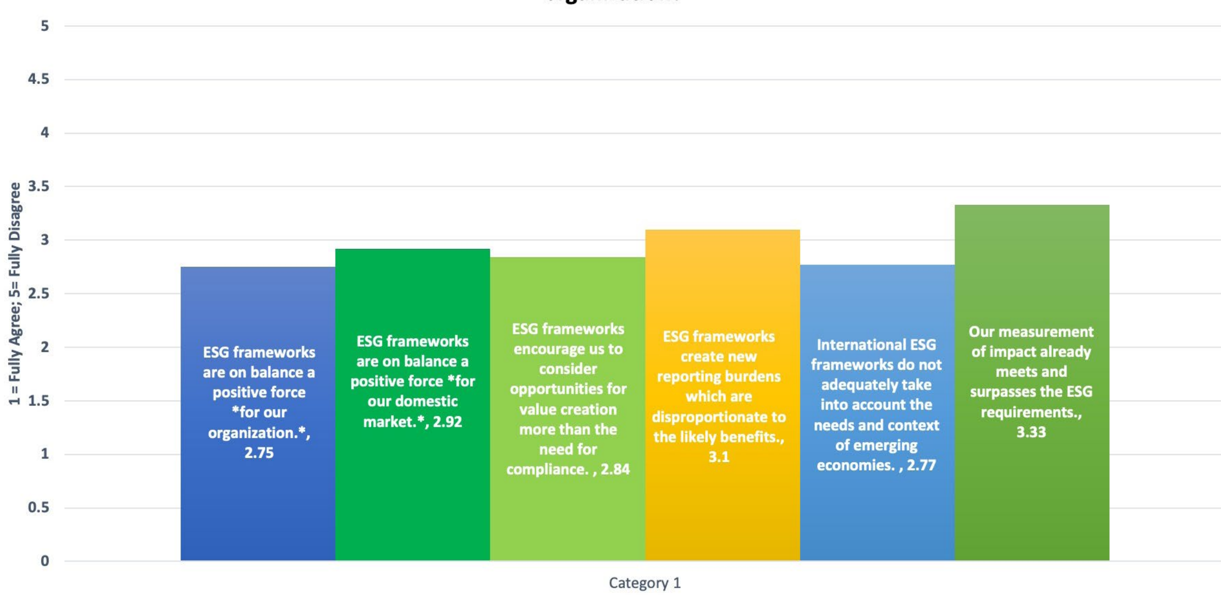
Generally, the responses show neither agreeing or disagreeing with most ESG statements/questions, showing a NEUTRAL view.

However, given further questioning, it can be extrapolated organizations DO NOT fully understand what ESG looks like for their organizations at this time. Organizations want to remain engaged on ESG framework, but do not want to have more burden then benefits.

Fully Agree	Agree	Neither Agree nor Disagree	Disagree	Fully Disagree
1	2	3	4	5

ESG frameworks are on balance a positive force *for our organization.*	ESG frameworks are on balance a positive force *for our domestic market.*	ESG frameworks encourage us to consider opportunities for value creation more than the need for compliance.	ESG frameworks create new reporting burdens which are disproportionate to the likely benefits.	International ESG frameworks do not adequately take into account the needs and context of emerging economies.	Our measurement of impact already meets and surpasses the ESG requirements.
2.75	2.92	2.84	3.10	2.77	3.33

How important is it to have people with skill and knowledge of ESG issues inside your organization?



REPORT ANNEX

Materiality Assessment

Most financial institutions rank organizational knowledge of ESG issues as **IMPORTANT NOW, with ALL responses saying it is likely to be important in the near future.**

Almost ALL financial institutions understand that ESG reporting, whether in depth or breath, will affect their own reporting processes in the near term. **About 2/3rds do not fully understand how ESG reporting will impact or effect their business.**

How important is it to have people with skill and knowledge of ESG issues inside your organization?

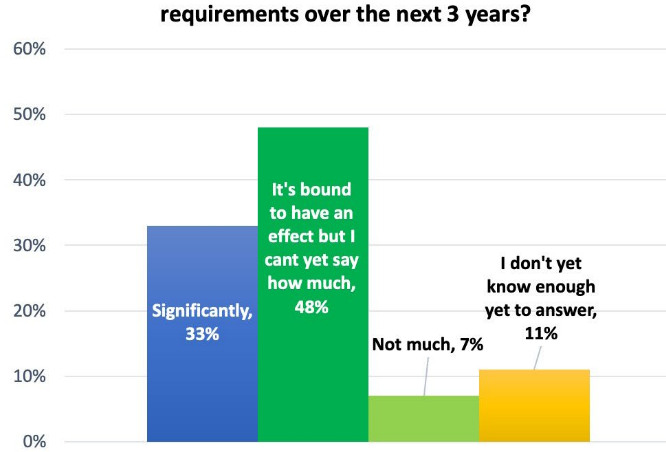
Very important now	Important now	Not important now but it is likely to become important within 5 years
30%	40%	30%

How much is your depth or breadth of reporting likely to change as the result of ESG pressures or requirements over the next 3 years?

Significantly	It's bound to have an effect but I cant yet say how much	Not much	I don't yet know enough yet to answer
33%	48%	7%	11%

How important is it to have people with skill and knowledge of ESG issues inside your organization?

How much is your depth or breadth of reporting likely to change as the result of ESG pressures or requirements over the next 3 years?



REPORT ANNEX

Capacity and Current Practices

Financial institutions are SPLIT on having a designated manager for ESG knowledge. Typically the manager has assumed multiple roles/responsibilities, or there is not a designated manager.

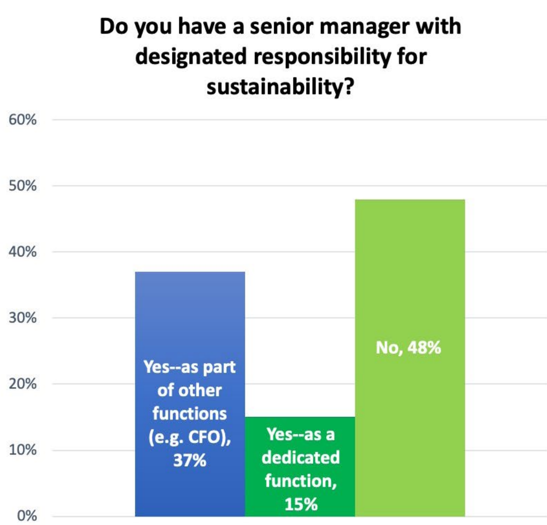
Financial institutions boards of directors are SPLIT on knowing relevant ESG issues for their circumstances. Half have identified and review, while the other half have not but have expressed interest.

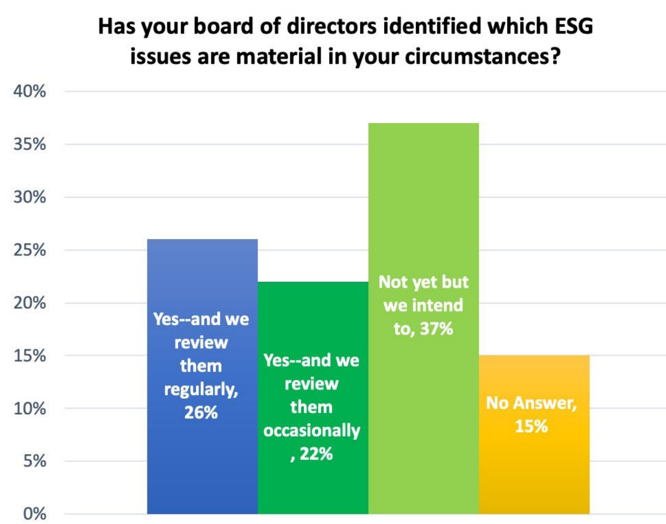
Do you have a senior manager with designated responsibility for sustainability?

Yes--as part of other functions (e.g. CFO)	Yes--as a dedicated function	No
37%	15%	48%

Has your board of directors identified which ESG issues are material in your circumstances?

Yes--and we review them regularly	Yes--and we review them occasionally	Not yet but we intend to	No Answer
26%	22%	37%	15%





REPORT ANNEX

Capacity and Current Practices

Financial institutions are SPLIT on how they report SDGs achievements. 40% have indicated they report, 40% do not report, and 20% currently do not report but wish to.

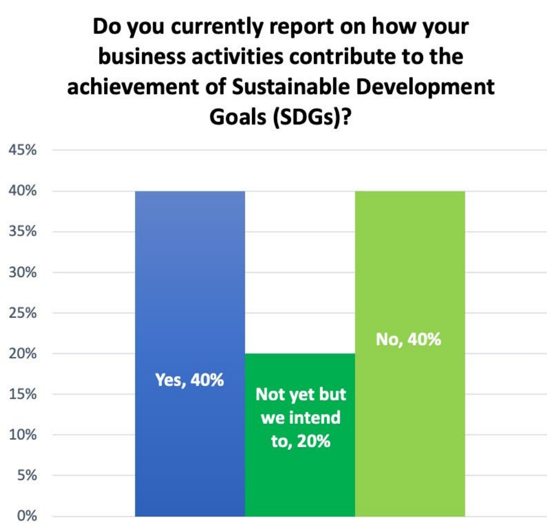
While financial institutions have been split on their ESG capacity and current practices, MOST express limited knowledge on ESG issues with room for improvement.

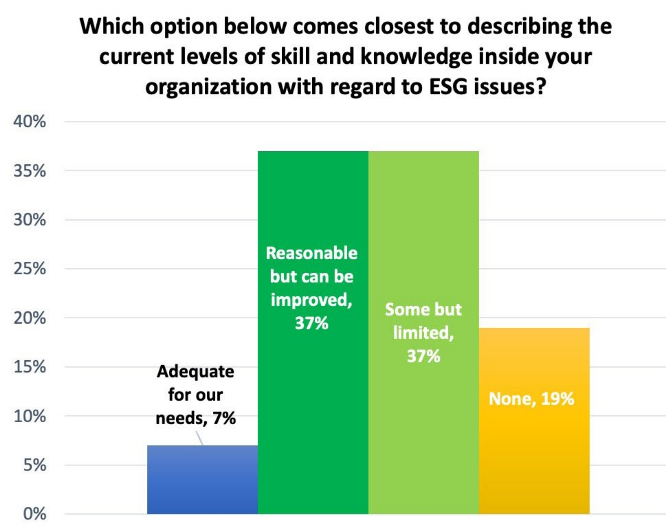
Do you currently report on how your business activities contribute to the achievement of Sustainable Development Goals (SDGs)?

Yes	Not yet but we intend to	No
40%	20%	40%

Which option below comes closest to describing the current levels of skill and knowledge inside your organization with regard to ESG issues?

Adequate for our needs	Reasonable but can be improved	Some but limited	None
7%	37%	37%	19%





REPORT ANNEX

Engagement Metrics

About 2/3rds of financial institutions DO NOT discuss ESG issues with domestic or international trade groups.

Financial institutions have said YES to being involved in more ESG discussions, and implications of ESG frameworks.

Do you discuss ESG issues generally in any domestic or international trade groups of which you are a member?

Yes	No
37%	63%

Would you like to be part of more discussions about the implications of ESG frameworks?

Yes--with either or both domestic and international	Yes--especially if they are with domestic organizations like mine	No Answer
70%	7%	23%