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GREENING THE FINANCIAL SYSTEM: ENHANCING COMPETITIVENESS THROUGH ECONOMIC DEVELOPMENT

A Briefing

KEY MESSAGES

- Green finance made substantial progress and gained prominence as an important asset class. New green financial products are facilitating investment in green and resilient businesses and infrastructure.
- The Task Force on Climate-related Financial Disclosures (TCFD) recommendations can alter market practice by boosting environmental risk visibility, assisting investment and lending decision-making. Early evidence points to promising impacts on innovation, strategy shifts and cultural change.
- Effective public and private action is needed for a step change in the speed and scale of green finance, keeping in mind the broader effects on competitiveness, risk management and sustainable development.
- Smart use of public money, such as using blended finance to lower risks that private investors avoid, is critical to maximize the leverage of private capital.
- Development banks and financial institutions play a key role in catalysing private finance through balance sheets as well as standard setting power.
- The rapid development and disrupting potential of financial technology (fintech) holds great opportunities to broaden the investor base and unlock new business models for green finance.

Bloomberg Philanthropies, the European Banking Federation (EBF), the Institute of International Finance (IIF), the Paulson Institute, the Securities Industry and Financial Markets Association (SIFMA) and UN Environment co-hosted a roundtable for market and policy leaders in Washington, D.C. on 20 April 2017. The goal of the event was to explore pathways to scale and speed up green finance and to harness its benefits for long-term sustainable growth and competitiveness.

> “Green finance is not just about green bonds and green funds. It is about greening the global economy. It is about the fact that there are millions of investors making billions of decisions on trillions of assets under management that overlook or assume away the one-planet-boundary condition.”

GREENING THE FINANCIAL SYSTEM – TRACKING PROGRESS

Aligning the financial world with green growth is essential to reaching the ambitious goals of the Paris Climate Agreement and the 2030 Agenda. Given the continued fiscal pressure in many parts of the world, mobilizing private capital is essential to meet the global investment needs of US$5-7 trillion per year. Green finance holds vast opportunities for long-term, profitable investment in both developed and developing countries. Investment in green infrastructure will set the trajectory for the carbon footprint in the future given the long-term nature of infrastructure projects. The challenges for financial markets lie in connecting supply and demand, bridging temporal mismatch and "industrializing" green finance out of its current niche. In short, we need a step change in greening the financial system.

The financial system is already greening. A rising awareness of commercial opportunities, sustainability risks and a changing perception of client appetite for socially responsible investing have led to a surge of market innovation in the recent years, including green bonds and associated standards, ESG evaluation systems and indices, specialized credit lines and green fintech services. Governments have facilitated these developments through policy signalling, national roadmaps, sectoral guidelines and incentive systems. Culture is shifting, as green finance has moved from the fringes to the centre of financial market discussions, and is increasingly seen as making good business sense, including by former sceptics. A new sense of competition between companies and financial centres for green finance leadership is emerging.

At the international policy level, progress is also advancing. China, under its 2016 G20 Presidency, launched the Green Finance Study Group (GFSG), placing the issue in the financial rather than environmental track. Germany is taking the Chinese initiative forward, both in the GFSG – with a two-fold focus on advancing environmental risk analysis and improving publicly available environmental data – and in other G20 work streams. Finally, Argentina has signalled its intention as incoming G20 President to continue the work of its predecessors. In parallel, the Financial Stability Board-mandated Task Force on Climate-related Financial Disclosures (TCFD) is finalizing its recommendations for forward-looking climate risks analysis and has already received a one-year extension of its mandate to support capacity building and implementation.

PUBLIC AND PRIVATE PATHWAYS TO SCALE AND SPEED

Mainstreaming green finance requires a balanced mix of effective market and policy action.

Market actors should continue to focus on continued innovation to unlock green investment opportunities, building robust environmental risks analysis and management systems, and engaging with policymakers to support public action where needed. The following options and examples can guide effective market action:

* *Driving forward-looking environmental risk analysis and disclosure.* The TCFD's recommendations can be brought to life if a multi-sector group of institutions spanning all geographies pioneer their adoption. In a first phase, this would require internal capacity building, tool and methodology development and engaging in publicly facilitated learning processes.

- *Connecting environmental risk analysis with core business activities.* According to ICBC, the world's largest bank by total assets, loans to green businesses and sectors have lower default rates than non-green loans. Consequently, it introduced an internal penalty-subsidy system to offer preferential loans to green projects financed by higher interest rates on loans to polluting sectors.
- *Feeding back into the policy process.* Market participants should clearly communicate their need for robust, reliable policy signals and environments to governments and international bodies, particularly where administrations are hesitant. As a part of this, financial institutions should voice expectations and support for the G20 work on green finance going forward. Where applicable, firms should communicate the business case for green finance in the context of risk management and competitiveness factors.

> "Digitalisation will reshape the financial system, and with it the opportunities and risks to advance green finance – a trend we need to understand better and engage with and influence now."

- *Harnessing financial technology to strengthen retail demand and unlock new opportunities.* Financial technology has a vast potential to raise awareness for green finance at the retail level. One example is ANT Financial's mobile payment platform, which offers an optional carbon footprinting service currently used by over 200 million users. Fintech and related technological revolutions are rapidly reshaping markets and opening new green business opportunities (such as mobile-based payment systems for off-grid renewable energy), many of them in developing countries. To this end, ANT and UN Environment launched the Green Digital Finance Alliance in January 2017
- *Anchoring sustainability at board and executive level and in incentive structures.* Specific expertise on sustainability needs to be anchored at the board and executive level, and integrated in executive search criteria to help drive change from the top. Evidence points to positive experiences with integrating sustainability performance indicators in bonus structures.

Governments should shape effective, predictable and enabling policy environments that minimize market failures and create the conditions for a rapid scaling up of green finance. They can use broader policy packages including environmental regulation, pricing reforms and fiscal policy, but also interventions to support the greening of financial markets, with options such as:

- *Creating smart and efficient incentive systems to catalyse green finance.* The Monetary Authority of Singapore, for example, has recently announced a subsidy scheme that will cover the additional cost of issuing a green versus a vanilla bond, such as the price of green certification – an effective way to ensure quality, attract green bond issuers and build a financial centre profile.
- *Using limited public means effectively.* To optimize the leverage of private funds, governments should use public finance to de-risk the specific aspects of green investments – which may differ across countries and sectors – that may discourage private investors.
- *Supporting harmonization, capacity building and data provision.* To implement forward-looking, scenario-based environmental risk analysis as recommended by the TCFD, governments and international bodies can promote knowledge sharing and support asset owners and managers with harmonized tools, sector-specific scenario data, learning platforms, and by teaching the teachers.

> "The old adage of 'build the field, and they will come' applies quite aptly to green finance. I have worked on a number of transactions in the last few years where CFOs and CEOs that were, not long ago, viscerally sceptical about green finance have now signed on and executed deals that are in large part redefining their cultures."

Finally, **multilateral development banks (MDBs), international financial institutions (IFIs) and organizations** also have an important role to play, with options available both for their balance sheets activities and their influence on standards and practice formation:

* *Filling project pipelines, backing green bonds and promoting financial market development.* A lack of investable projects – not a lack of investor demand – is one of the key barriers to green investment in developing countries. MDBs can achieve the best leverage by bringing projects to a bankable state and supporting local financial capacities to package them and issue green bonds. Further, backing such bonds with MDBs' triple-A ratings can mitigate the concerns of investors less familiar with investing in developing countries.
* *Aligning portfolios and governance structures with the ambitions of the Paris Agreement.* MDBs need to be role models in aligning investment portfolios with low-carbon development. They can pioneer stress-testing for 2°C scenarios and facilitate private sector adoption by releasing best-practice tools and methodologies. Similarly, they need to pioneer the necessary cultural and internal change by installing incentive systems and capacity development.
* *Using standard-setting power to strengthen and harmonize environmental and governance guidelines.* The absence of a widely accepted, stringent standard for sustainable and resilient infrastructure projects is a pressing issue for infrastructure investors. By upgrading and harmonizing environmental performance standards to be 2°C-aligned, development banks could guide broader markets, ensure quality and support urgently needed investment in green infrastructure. Similarly, the OECD could strengthen environmental and climate-related provisions in its corporate governance guidelines.

HARNESSING COMPETITIVENESS AND MAXIMIZING DEVELOPMENT BENEFITS

> "What we are seeing is that – despite political difficulties, just from our commercial interests – dealing with climate change and moving towards sustainable investment has now reached escape velocity."

The effects of green finance on competitiveness are beginning to emerge at various levels of the financial system. Overall, the process is developing from the micro to the macro level. Asset managers and financial intermediaries have already engaged in competition for green products and services, and are building out sector- or product-related specializations. Financial centres like London, Paris, Shanghai, Casablanca or Luxembourg are positioning themselves as global centres for green finance, aiming to attract specialized companies to build clusters. At the country level, the financial policy debate includes the competitiveness benefits of green finance, both in countries with highly developed financial sectors – such as Singapore or Switzerland – and in countries where investing in a green and resilient economy is particularly important for future development, such as Brazil or Bangladesh. Designing smart policy and market systems to maximize the positive effects on long-term competitiveness and productivity can be a powerful lever to muster political support and scale up green finance.

The broader sustainable development benefits of green finance are another emerging topic. Developing countries face particularly large investment gaps and receive – if BRICS are excluded – only a minor share of current green financial flows, even though they offer large opportunities for long-term green investment in resilient infrastructure, energy, transport and agriculture. The green finance debate needs to distinguish opportunities, needs and barriers of developing countries, and foster targeted innovation to match such opportunities with investor demand. Many developing countries have announced green bond roadmaps and plan to issue their first sovereign bonds soon, highlighting the potential for green finance to play an important role in closing the sustainable development funding gap.

Meanwhile, other effects of improved environmental risk analysis need to be better understood in order to anticipate and manage possible development policy implications, such as potential effects on sovereign credit ratings. UN Environment, together with the group of the Vulnerable 20, is exploring this topic and developing options to maximize synergies between green finance and broader sustainable development.

ROLE OF THE G20

> "The G20 green finance track may be the best example of how the G20 and private sector can work together to the benefit of both."

While political challenges in the G20 remain, the group continues to play an important role in policy signalling, harmonization and embedding of green finance in the broader sustainable growth agenda. Going forward, the G20 should continue to use its mandate to catalyse, strengthen and facilitate market-led efforts, initiatives and innovations. Options for the current and incoming troika include:

- Supporting market efforts to improve risk management and disclosure by endorsing the TCFD recommendations, calling for implementation and setting out next steps to drive adoption and facilitate peer learning
- Calling on governments, MDBs, IFIs and relevant international organizations to use their balance sheets and standard-setting powers to leverage sustainable, resilient and low-carbon investment
- Upgrading the Green Finance Study Group to a working group and deepening the analysis of benefits to growth, competitiveness and global productivity emerging from green finance.

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