The Financial System We Need
Aligning the financial system with sustainable development

Nick Robins, Greeninvest, Lima, October 2015
INQUIRY: key insights

Financing for sustainable development can be delivered through measures focused on the financial system, as well as the real economy.

A growing number of policy innovations have been introduced by both developing and developed countries, demonstrating how the financial system can be better aligned with sustainable development.

Systematic national action can now be taken to shape a sustainable financial system, informed by current trends and complemented by international cooperation.

[Source Inquiry, 2015]
INQUIRY: mandate and practice

MANDATE

Identify policy options for aligning financial system with sustainable development

→ Focused on environment

ANALYSIS FRAMEWORK

Lever for change

Initial assessment of potential for impact and ease, cost and risk

FINDINGS

Diverse starting points → clusters of approaches emerging

NEXT STEPS

Recommendations for national action and international collaboration

FRAMEWORK FOR ACTION

Packages of policy proposals

TOOLKIT

38 approaches in four clusters

Upgraded governance
FOCUS ON PRACTICE

**UK**
Bank of England, CISL, Oxford University

**China**
People’s Bank of China Development Research Centre, IISD

**South Africa**
Bankers Association, Johannesburg Stock Exchange

**Netherlands**
Ministry of Environment Utrecht Sustainable Finance Lab

**France**
2 Degrees Initiative, France Strategie, I4CE

**Canada**
The Cooperators, CIGI

**US**
CalPERS, SAIS

**Colombia**
Ministry of Finance IFC

**Brazil**
Bankers Federation Fundação Getulio Vargas

**Kenya**
Bankers Association Central Bank IFC

**Switzerland**
Federal Office of Environment

**Bangladesh**
Bangladesh Bank, Council on Economic Policies

**Indonesia**
Financial Services Authority (OJK) IFC, ASRIA

**India**
FICCI, NIPFP

[Source Inquiry, 2015]
A SYSTEMIC CHALLENGE

TOO MUCH OF THIS

NOT ENOUGH OF THIS

CRITICAL CHALLENGES

US$16 trillion

Annual global investment
All needs to be green and resilient

US$ 5-7 trillion

Annual investment needed for sustainable development goals e.g. in infrastructure, energy, agriculture

US $ 7 trillion

Annual environmental externalities – need to be costed into decision making

US$ 6 trillion

Reduction in fossil fuel and power investment need (2015-2030)

[Source Inquiry, 2015]
ALIGNING THE SYSTEM

FINANCIAL ASSETS & ACTORS

- **Banking**
  - US$135 tn

- **Bonds**
  - US$100 tn

- **Equities**
  - US$70 tn

- **Investors**
  - US$100 tn

- **Insurance**
  - US$29 tn

PRIORITY FOR ALIGNMENT

- **Real economy regulation & pricing**
- **Mobilising public spending**

REASONS FOR ACTION IN THE FINANCIAL SYSTEM

- **Managing risk**
  - Inadequate risk management in the financial system may exacerbate environmental & social externalities

- **Promoting innovation**
  - Upgrading the standards and regulations required to catalyze investment, for example, in bond markets

- **Strengthening resilience**
  - Environmental factors can pose risks to assets and system stability

- **Ensuring policy coherence**
  - Ensuring coherence between financial regulation and wider goals, such as long-term investment, access to finance, environmental security.

[Source Inquiry, 2015]
**FINDINGS:** ‘a quiet revolution’ 100+ measures globally

**Diverse starting points**
- Financial inclusion, greening industry
- Air pollution
- Infrastructure investment
- Post-crisis rebuilding of trust in finance
- Climate change

**Levers for action**
- Enhancing market practice
- Harnessing the public balance sheet
- Directing finance through policy
- Transforming culture
- Upgrading governance

**Measures in practice**
- Integration in prudential banking regulation
- New investor reporting requirements on climate
- Coordinated roadmap led by regulator
- Financial sector compact
- Incentives for clean energy bonds

[Source Inquiry, 2015]
BRAZIL: A first mover in sustainability

Enhancing the market: BM&F Bovespa stock exchange launch ISR Index in 2005

Managing risks: In 2014, BACEN introduced new requirements for banks to manage socio-environmental factors as part of core risk system to improve governance and strengthen soundness.

Performance measurement: Brazilian Bankers Association (FEBRABAN) starting to track green lending flows.

“Sustainability is a positive asset for financial and monetary stability”
Aloisio Tupinamba, Chief of Staff, Financial Regulation, Central Bank of Brazil
CHINA: Greening the financial system

Green investment needs: US$400bn p.a to finance green investment; only 15% from public sources.

Green financial system: The People’s Bank of China co-authored a set of proposals with the Inquiry on closing the gap: green bonds, green ratings, lender liability, environmental insurance, stock market disclosure.


“Greening a country’s financial system is not an “additional” performance requirement but concerns the efficiency and effectiveness of the whole system.”
Development Research Council of the State Council, China.
Fiduciary Duty: Law Commission review clarified that material sustainability factors part of prudent investing.

Prudential Regulation: The PRA is examining the impact of climate on safety and soundness of insurance companies: physical and transition risks.

Green Finance: The Green Investment Bank instrumental in creating a new class of ‘renewable investment trusts’

“The central bank time horizon is relatively short. But the real challenges to prosperity and economic resilience from climate change will manifest well beyond this. We face a ‘tragedy of horizons’.” Mark Carney, Governor, Bank of England
### FRAMEWORK FOR ACTION: Tools, policies and governance

#### Tools
- **Enhancing market practice:** Disclosure, responsibilities, product criteria
- **Harnessing public balance sheet:** Fiscal incentives, public institutions & central banks
- **Directing finance through policy:** Priority sectors, regulatory calibration, liability frameworks
- **Transforming culture:** Capacity building, financial behaviour, market structure

#### Policy packages
- **Banking:** Extend risk based governance, improve access, enhance culture
- **Bonds:** Scale up green bonds, extend credit analysis
- **Equities:** Market disclosure, sell-side research
- **Investment:** Pensions governance, transparency and incentives
- **Insurance:** Access, prudential governance & investment role

#### Governance
- **Principles** for a sustainable financial system
- **Compacts and pathways**
- **Policy and legal frameworks**
- **Regulatory mandates**
- **Performance measurement**

[Source Inquiry, 2015]
### SCALING UP DEBT CAPITAL MARKETS

<table>
<thead>
<tr>
<th>1. Market Integrity: common definitions, standards, verification, certification</th>
<th>6. Improving returns: through tax credits and incentives</th>
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<tr>
<td>2. Pipeline Development: enabling issuers and investors to plan ahead and build expertise</td>
<td>7. Purchase by public funds: through mandates for sovereign wealth funds and pension funds</td>
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<td>5. Improving risk return: credit enhancement: partial guarantees, subordinated debt</td>
<td>10. International cooperation: underpinning market liquidity through mutual recognition</td>
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[Source Climate Bonds Initiative, World Bank & UNEP Inquiry, 2015]
## MOBILISING INSTITUTIONAL INVESTORS

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<tr>
<td><strong>1. System Design:</strong></td>
<td>Integrate adequacy, affordability &amp; sustainability</td>
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<td><strong>2. Fiduciary Duty:</strong></td>
<td>Clarify that fiduciaries must take account of sustainability</td>
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<td><strong>3. Governance:</strong></td>
<td>Include sustainability in skills &amp; capabilities (fit &amp; proper) tests</td>
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<td><strong>4. Prudential:</strong></td>
<td>Calibrate capital requirements &amp; extend horizons</td>
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<td><strong>5. Structure:</strong></td>
<td>Consider whether consolidation needed for delivery</td>
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<td><strong>6. Standards:</strong></td>
<td>Provide guidance on OECD and other guidelines</td>
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<td><strong>7. Incentives:</strong></td>
<td>Encourage alignment of fees along the investment chain</td>
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<td><strong>8. Fiscal:</strong></td>
<td>Review to encourage long-term sustainable value creation</td>
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<td><strong>9. Disclosure:</strong></td>
<td>On stewardship and sustainability performance</td>
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<td><strong>10. International:</strong></td>
<td>International code on investor duties and sustainability</td>
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[Source Inquiry, 2015]
FRANCE: Improving financial transparency

How to shift the trillions?

MAY 29th, 2015 - PARIS, FRANCE
UNESCO HEADQUARTERS

ENERGY TRANSITION LAW

Corporations: disclose exposure to financial risks linked to climate change, contribution to climate change and strategic actions

Banks: incorporate climate factors into stress tests - end of 2016

Investors: disclose how they manage sustainability factors, carbon footprint and contribution to the energy transition

“It is essential that the financial system as a whole takes climate risk into account, anticipates ambitious targets and integrates this into investment decisions.”

Laurent Fabius, Foreign Minister, France
NEXT STEPS: Acting nationally and internationally

SYSTEM LEVEL COLLABORATION
- Principles
- Disclosure convergence
- Sustainability stress test
- Fiscal measures optimisation
- Performance framework

NATIONAL COMPACTS & PLANS
- Diagnostic & metrics
- Implement and learn
- Build coalition
- Assess options
- Design pathway

SECTOR LEVEL COLLABORATION
- Global banking standards
- Code on investor duties
- Coalition for greening debt & capital markets
- Guidance for insurance regulators

INTERNATIONAL COLLABORATIVE RESEARCH ALLIANCE

[Source Inquiry, 2015]
INQUIRY LIVE  www.unepinquiry.org

Global Report
(English + 6 languages)

Policy Summary

Country research  Thematic reports  Working papers

[Source Inquiry, 2015]
INQUIRY: conclusions

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[Source Inquiry, 2015]
For more information

www.unep.org/inquiry/

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