THE BANKING SECTOR'S CONTRIBUTION TO SUSTAINABLE GROWTH – RISK ASSESSMENT, SUSTAINABLE FINANCE, VOLUNTARY INITIATIVES AND REGULATIONS

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BACKGROUND

- The financial sector plays a central role in channeling financial capital into businesses, projects, and sectors.
- A report by the Stockholm Environment Institute estimates that between US$363 billion to US$2.4 trillion have to be invested only to mitigate climate change.
- How does this affect the financial sector and how can the Financial Sector Contribute to a Solution?

INTEGRATING SUSTAINABILITY INDICATORS INTO CREDIT RISK ASSESSMENT

- Environmental regulations
  - » CERCLA
- Security risks of sites used as collateral that are contaminated
  - » Contamination of a site affects the collateral value
- Reputation risk
  - » Banks attract bad reputations because of bad reputation of a debtor
- Influences on the ability to repay the loan
  - » Debtors can be obliged to invest in environmental technologies because of regulations
- Changes in environmental attitudes of consumers or industries influence the business performance of a debtor

SUSTAINABLE CREDIT RISK ASSESSMENT

- Adding sustainability indicators to conventional criteria
- Significant increase of the predictive validity of the credit risk assessment
  - » Global studies, Bangladesh, Germany
- Reduction of financial risks for lenders
- Channeling loans to ‘sustainable’ borrowers

FINANCING SUSTAINABLE DEVELOPMENT / CARBON FINANCE

- Schmidheiny and Zorraquin: Financing Change (1996)
- Socially Responsible Investing
- Sustainability Indices
  - » Dow Jones Sustainability Index
  - » FTSE for Good
- Financing projects under the Kyoto Protocol
  - » CDM, JI
- Chicago Climate Exchange

VOLUNTARY CODES OF CONDUCT

- UNEP Financial Initiative
  - » Identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations
- Equator Principles
  - » Set of guidelines for managing social and environmental issues related to the financing of development projects.
- UNPRI (Principles for Responsible Investing)
  - » Environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios.
  - » Integrating ESG as a part of fiduciary responsibility

ISSUES OF VOLUNTARY CODES OF CONDUCT

- Focus on financial risks instead of sustainability impacts
  - » Outside-in instead of inside-out
- Connection to sustainability issues
- Enforcement
- Compliance
- Window dressing, greenwashing

CURRENT TRENDS

- Financial Sustainability Regulations
- Stranded Assets, Carbon Bubble, and Divestment

FINANCIAL SUSTAINABILITY REGULATIONS

Country	Name of Policy	Year(s) of Launch
Bangladesh	Environmental Risk Management (ERM) Guideline	2011
Brazil	Protocol Verde, Socio - Environmental Liability Policy	2009, 2012
Colombia	Green Protocol	2012
China	Green Credit Guidelines	2007, 2012, 2014
Indonesia	Roadmap for Sustainable Finance in Indonesia	2014
Mongolia	Mongolian Sustainable Finance Principles and Sector Guidelines	2014
Nigeria	The Nigerian Sustainable Banking Principles	2012

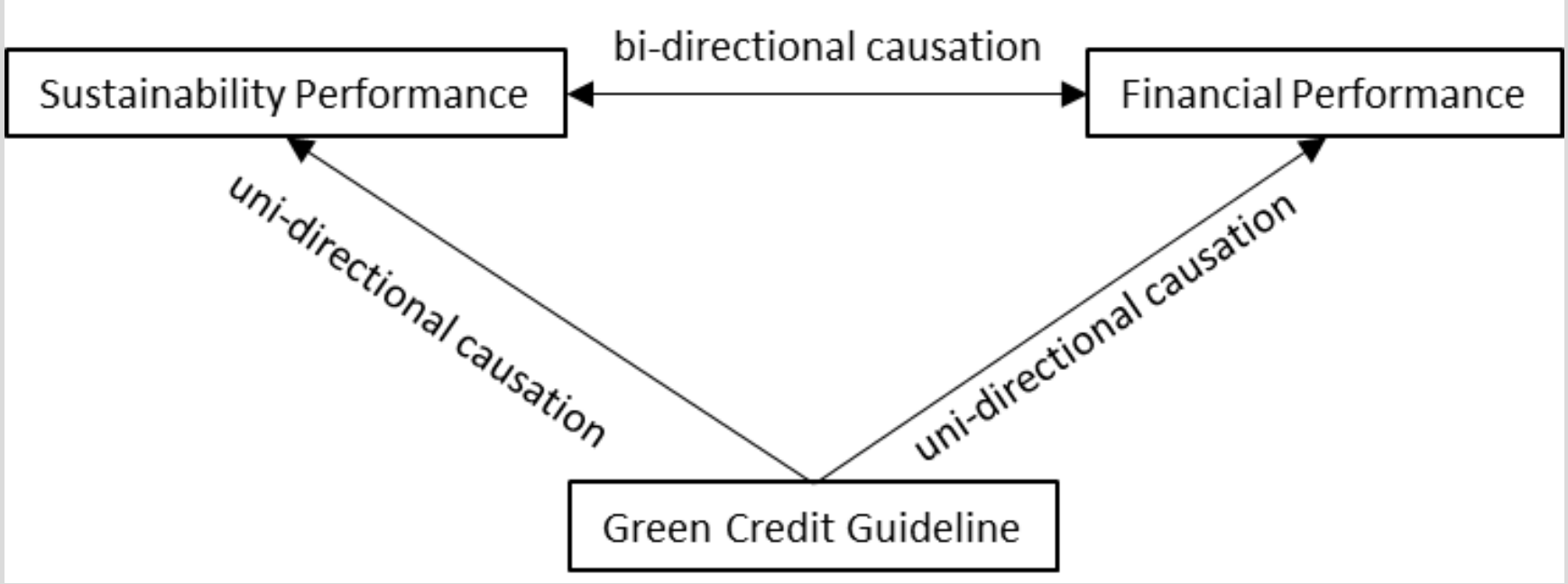
NIGERIA

- Nine Principles
  - » E&S risk management, E&S footprint, human rights, women's economic empowerment, financial inclusion, E&S governance, capacity building, collaborative partnerships and reporting
- High rate of Adoption
- Started as a Voluntary Initiative
- Influenced by Foreign Investors

CHINA

- Flexible interest rates for environmentally friendly and for polluting industries
- Implementing assessment and pricing systems
- Reducing the amount of loans to polluting industries
- Addressing financial risks for the financial sector arising from environmental risks

INTERACTION



REASONS FOR REGULATIONS

- The financial sector is easier to control than in developed countries
- Regulations can be easier enforced in one sector than in a number of different sectors with environmental impacts
- External financiers influence regulators to guarantee the sustainable investment of foreign financial capital

STRANDED ASSETS AND CARBON BUBBLE

- IPCC: Only a small part of the remaining fossil fuel reserves can be burnt in order to mitigate climate change
  - » What are the consequences for the financial sector?
  - » Are the risks managed appropriately?
- Bank of England Inquiry

DIVESTMENT

- Firms that are Contributing to Climate Change should not be Invested in
- Divestment from Coal and Oil
  - » 350.org
  - » Universities
  - » Institutional Investors
- Consequences are still unclear

CONCLUSIONS

- Products, services, and processes focusing on creating a positive impact on sustainable development are existing for some decades but are still mainly niche products
- Sustainability has not found entrance into financial sector regulations
- More research is needed to explore the most effective and efficient ways to connect the financial sector with a green economy transformation and sustainable development

THANK YOU!

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