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

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CONTENT

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• Integrating Sustainability Indicators into Credit Risk Assessment
• Financing Sustainable Development and Carbon Finance
• Voluntary Codes of Conduct
• Current Trends
• Conclusions and further Research Needs
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

- Socially Responsible Investing
- Sustainability Indices
  » Dow Jones Sustainability Index
  » FTSE for Good
- Financing projects under the Kyoto Protocol
  » CDM, JI
- Chicago Climate Exchange
• 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

<table>
<thead>
<tr>
<th>Country</th>
<th>Name of Policy</th>
<th>Year(s) of Launch</th>
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<tbody>
<tr>
<td>Bangladesh</td>
<td>Environmental Risk Management (ERM) Guideline</td>
<td>2011</td>
</tr>
<tr>
<td>Colombia</td>
<td>Green Protocol</td>
<td>2012</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Roadmap for Sustainable Finance in Indonesia</td>
<td>2014</td>
</tr>
<tr>
<td>Mongolia</td>
<td>Mongolian Sustainable Finance Principles and Sector Guidelines</td>
<td>2014</td>
</tr>
<tr>
<td>Nigeria</td>
<td>The Nigerian Sustainable Banking Principles</td>
<td>2012</td>
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</tbody>
</table>
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

- Sustainability Performance
- Financial Performance
- Green Credit Guideline

Bi-directional causation:
- From Sustainability Performance to Financial Performance
- From Financial Performance to Sustainability Performance

Uni-directional causation:
- From Sustainability Performance to Green Credit Guideline
- From Green Credit Guideline to Financial Performance
• 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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