



# **Inquiry:** Design of a Sustainable Financial System



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**FICCI-UNEP Conference on Designing a Sustainable**  
**Financial System for India**  
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**Aligning the Financial System with Sustainable Development**  
**Theme Presentation**

**By**  
**Nick Robins, Co-Director, Inquiry into the Design of a Sustainable Financial System,**  
**UNEP**

# Financial reform & sustainability



- Financial system reforms are **part of the solution** to rapidly scaling private capital for the green economy
- Such interventions can **complement** smart action in the real economy
- Examples of financial **policy innovation** are growing globally, yet remain fragmented
- The **time is ripe** for combining financial reform with long-term sustainability

*“In this age of diminished trust, it is the financial sector that takes last place in opinion surveys... [It] still prizes short-term profit over long-term prudence, today’s bonus over tomorrow’s relationship”*



# Inquiry's aim and approach

*“Advance policy options that would deliver a step change in the financial system’s effectiveness in mobilising capital towards a green and inclusive economy”*

**A 2 year mandate,  
reporting in late 2015**

**WHY** should rules governing the financial system be used in pursuit of green & inclusive outcomes ?

**WHAT** rules governing the financial system have been, and might be deployed as effective instruments?

**HOW** rules can be deployed given the complexities & competitiveness concerns of financial actors and nations ?

*“Financial regulators need to lead. Sooner rather than later, they must address the systemic risk associated with carbon-intensive activities in their economies.”*

**Jim Kim, President, World Bank**

# The Inquiry's Advisory Council



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Financial Services  
Authority, UK

# Working through partnership





# Why intervene in the financial system?

*Systematic  
market  
failures*

- Overcoming asymmetric information, misaligned incentives, short-termism and associated accountability failures.

*Systemic  
risks*

- Ensuring that the market can respond effectively to a new set of environmental and social risks

*Enabling  
innovation*

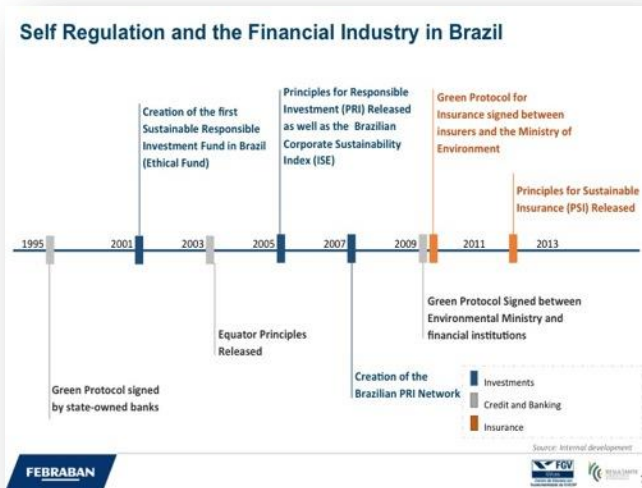
- Stimulating the standards and regulations required to catalyze productive financial innovation

*Policy  
coherence*

- Ensuring coherence between financial regulation and wider goals, such as employment, growth, financial inclusion or environmental security.



# Brazil: innovating for sustainability



**Mission directed finance:** Banco do Brazil & BNDES have sustainable development as their goal, driving credit allocation & considering green bonds

**Market disclosure:** The BM&FBovespa stock exchange has promoted sustainability for a decade driving ESG disclosure across all listings.

**Sustainability Risk Regulation:** Brazil's Central Bank (BACEN) issued guidance (2011) on sustainability under Basel III and has mandated (April 2014) that all banks require environmental & social risk systems. Concerns remain on financial liability for environmental damage



The Inquiry is working with Febraban and FGV to establish a baseline on financing for the green economy and identify priorities for further action across the Brazilian financial system



# China: steering the green transition



**System wide focus on green finance:** Strategic intent to install policy framework to steer capital away from resource/pollution intensive sectors, and towards resource efficient innovation

**Green Credit Guidelines:** The CBRC's Green Credit Guidelines now assess the entire balance sheet of licensed entities. Currently c8.9% of China's RMB60 trn lending is compliant; this is expected this to rise to 100%.

**Stranded assets:** China's resolve to rapidly reduce air pollution involves major investments, and enforced closure of iron and steel, cement and coal plants. Discussion of 'environmental stress tests' to identify assets at risk.

Green credit criteria taking shape

Updated: 2012-05-16 17:00

By Zheng Yanpeng ( chinadaily.com.cn)

**CHINADAILY**.com.cn

The Inquiry is collaborating with the Peoples Bank of China and the Development Research Center of the State Council to identify green financial policies, regulations and standards relevant to China



# South Africa: a tradition of transformation



Author: Ingé Lamprecht | 16 July 2013 12:42

**Financial sector commits extra R97bn to empowerment**



**Sustainability Governance:** South Africa has advanced a cluster of sustainability governance initiatives, including listing requirements under the JSE, King III, the Pensions Fund Act (Regulation 28) and the voluntary Code for Responsible Investing in South Africa (CRISA) for institutional investors

**Systemic Risk:** South Africa's Financial Stability Committee has already considered whether financial inclusion measures constitute a systemic risk and work is now starting to consider climate through the same lens

**Financial Sector Charter:** Negotiated with the financial sector over a decade, the Charter and its associated code and regulations is one of the world's most developed financial sector "social compacts"

Together, the Inquiry and the Global Green Growth Institute will explore these developments by engaging stakeholders such as industry associations, regulators (including Treasury), academics and financial intermediaries



theguardian

'Carbon bubble' poses serious threat to UK economy, MPs warn

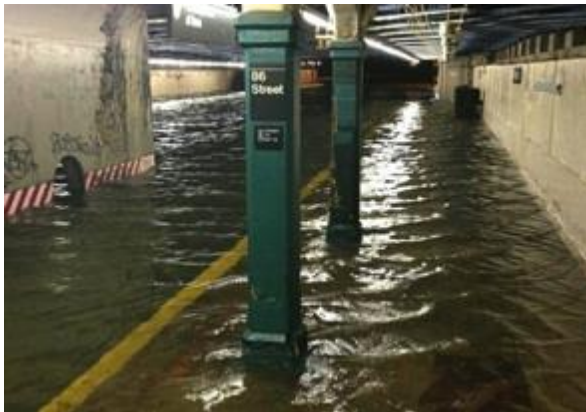
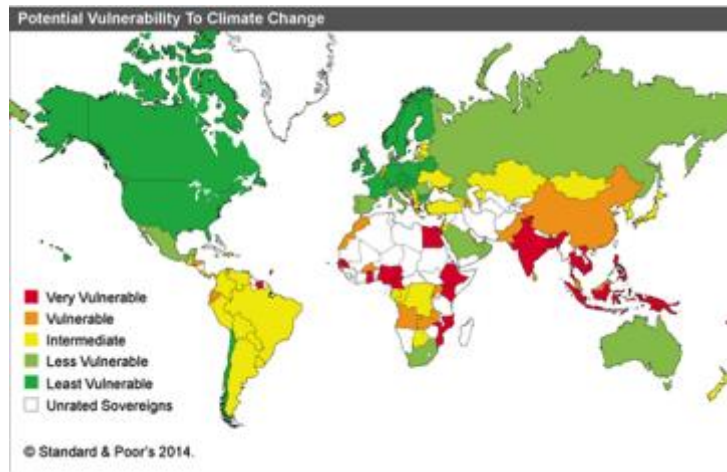
**Extending Responsibility:** The UK has introduced the Stewardship Code and new guidance on fiduciary duty to promote long-term investment incorporating sustainability factors

**Stranded Assets:** Investor concern about the potential threat of 'unburnable carbon' for fossil fuel' is prompting demands for better disclosure of climate risks

**Insurance Regulation:** The Prudential Regulatory Authority which regulates banks and insurers is exploring the links between climate change and insurance supervision

The Inquiry is working with UK investors, analysts and regulators to explore how to manage the long-term sustainability challenges for the UK financial system

# Critical issue: reducing environmental risk



- ⊙ Sustainability factors have the potential to **impair financial assets and trigger a disorderly market response**
- ⊙ **Stranded assets** the natural product of policy, technology, market & social change – **‘unburnable carbon’**
- ⊙ Need for financial standards which integrate sustainability factors into decision-making: **‘environmental stress tests’**

*How can environmental risk assessment be implemented across banking, insurance and investment sectors to anticipate future shocks?*



“Worsening financial performance as a result of climate event risk can negatively impact both short-term liquidity and long-term debt financing, leading to an increase in credit risk.”

**Standard & Poor's**

- ⊙ **Growing materiality** – Climate change is one of the two megatrends that will impact sovereign bonds in the 21<sup>st</sup> century
- ⊙ **Rapid growth of green bonds** – USD35bn issued so far in 2014 compared with USD11bn for the whole of 2013.
- ⊙ **Catalysing scale** – Expanding the market via principles, standards, credit enhancement, fiscal incentives



*What are the key policy options to mainstream sustainability in the world's largest asset class?*

# Critical issue: improving transparency



**Long-standing focus on corporate disclosure** Next generation reporting standards, with a greater focus on materiality and investment decision making.

**Mobilising global stock markets** through the Sustainable Stock Exchanges Initiative including Colombia, Egypt, India, Mexico, Nigeria, Poland, South Africa, Thailand, Turkey, UK, USA,

**Growing focus on investor disclosure** First portfolio footprint in 2005 and now **Portfolio Decarbonisation Coalition** will convene a critical mass of investors committed to measuring, disclosing and reducing carbon impact



*How can securities, investment & accounting rules strengthen voluntary leadership to drive both disclosure and use of sustainability information?*

# Financial innovation at the Climate Summit



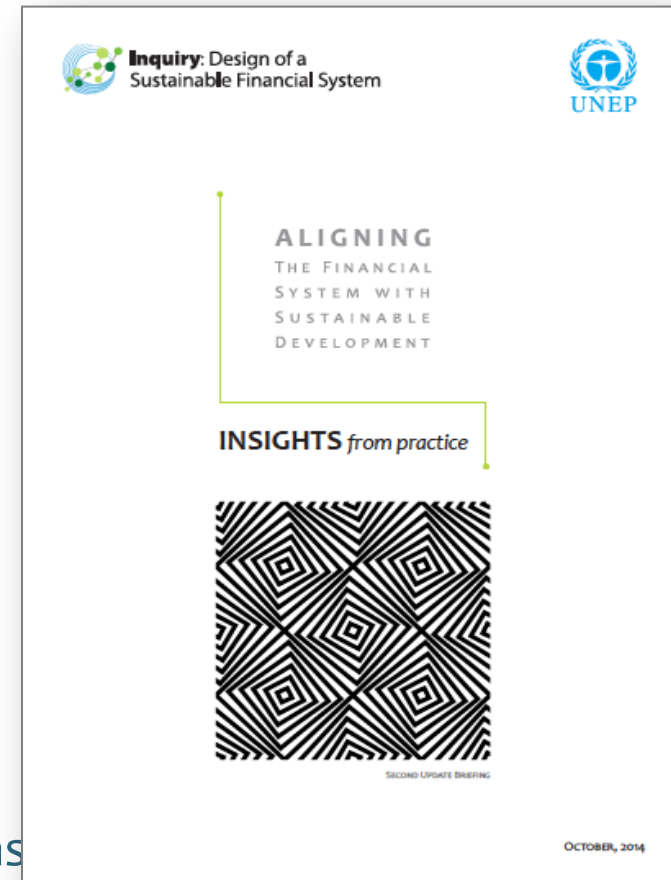
- **Policy coherence:** USD24trn AUM called on governments to ‘consider the effect of unintended constraints from financial regulations on investments in low carbon technologies and in climate resilience’
- **Market creation:** USD2trn AUM called on governments ‘to act through policy, regulation, risk mitigation, guarantees, tax credits to support issuance of bonds that address climate change’
- **Investor transparency:** The Portfolio Decarbonisation Coalition will engage ‘governments on eventual financial regulatory components’ of portfolio disclosure and decarbonisation for USD500bn AUM
- **Climate stress tests:** A UN and insurance sector coalition will explore how to apply 1 in 100 year solvency tests for natural disasters across the financial system in banking, investment and securities.

“My friends, this is it. We have 15 months to put a regulatory framework in place that is going to guide us over the next 30-50 years.” **Christiana Figueres, Executive Director, UNFCCC**

# Emerging themes



- Realising the **strategic role of the central bank** in sustainable development
- Aligning policies for **financial regulation, infrastructure and sustainable development**
- Deepening **sustainability risk management** – environmental stress tests
- **Capital re-balancing** via a strategic policy framework for equity & debt capital markets
- **Extending responsibility** for financial institutions – assessment, stewardship & transparency



**2015 - A Triple Policy Focus:  
Disaster Risk (Hyogo), Global Development (SDGs) & Climate (Paris)**



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**Nick Robins**  
Co-director  
[Nick.robins@unep.org](mailto:Nick.robins@unep.org)



**Simon Zadek**  
Co-Director  
[Simon.zadek@unep.org](mailto:Simon.zadek@unep.org)



**Mahenau Agha**  
Head of Outreach  
[Mahenau.agha@unep.org](mailto:Mahenau.agha@unep.org)



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[inquiry@unep.org](mailto:inquiry@unep.org)



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