



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

## Building a Sustainable Financial System *From Momentum to Transformation*

Simon Zadek, co-Director, Inquiry

Stockholm, December, 2016

# THE FINANCIAL SYSTEM WE WANT – 2<sup>ND</sup> EDITION



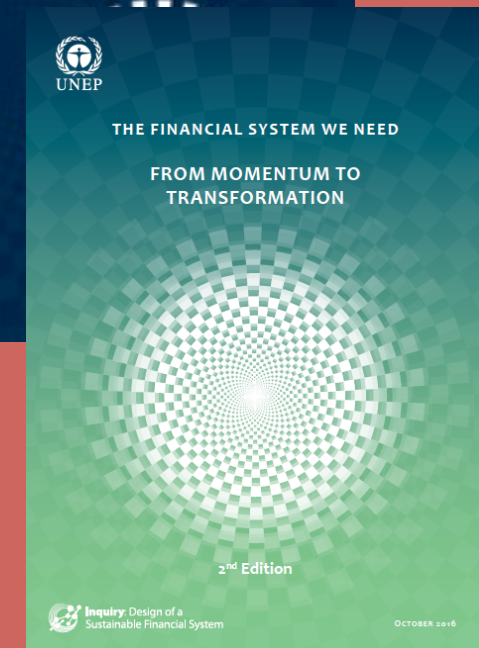
## ‘THE BOTTOM LINE’

A quiet revolution is changing the way in which the financial system responds to the sustainable development imperative

This year, the momentum has grown – in key capital markets, countries and global arena (e.g. G20)

This momentum, however, remains insufficient in terms of breadth, depth, scale and speed

A series of steps can help to deliver transformation – national strategies, fintech, leveraging public finance, building capabilities and developing common tools.



# WHY TAKE ACTION IN THE FINANCIAL SYSTEM?



## FINANCIAL ASSETS & ACTORS



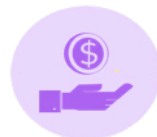
**Banking**  
US\$135 tn



**Bonds**  
US\$100 tn



**Equities**  
US\$70 tn



**Investors**  
US\$100 tn



**Insurance**  
US\$29 tn

## PRIORITIES FOR ALIGNMENT

*Real economy  
regulation &  
pricing*

*Mobilising public  
spending*

*Action within the  
financial system?*

## 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 create new markets and instruments.

### 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.

# THE UNEP INQUIRY APPROACH



## COUNTRY ENGAGEMENT\*

-  **CHINA:** green finance as a national strategy
-  **INDIA:** new tools for financing clean energy
-  **KENYA:** from mobile banking to green finance
-  **UK:** City of London Green Finance Initiative

## SECTORAL FOCUS\*



## INTERNATIONAL CO-OPERATION\*



United Nations



## 'THE FINANCIAL SYSTEM WE NEED'

### 1<sup>st</sup> Edition



2015: 'ALIGNING THE FINANCIAL SYSTEM WITH SUSTAINABLE DEVELOPMENT'



WORKING PAPERS (80+)

### 2<sup>nd</sup> Edition



2016: 'FROM MOMENTUM TO TRANSFORMATION'

\* Examples only

[downloadable at www.unepinquiry.org](http://www.unepinquiry.org)

# THE QUIET REVOLUTION JUST GOT LOUDER



**FINANCIAL STABILITY BOARD:**  
task force on climate-related  
financial disclosures



**CHINA:** adopts “guidelines for  
establishing a green finance system”

**GREEN BONDS:** Trillion  
dollar investment  
universe



**G20:** “it is necessary to  
scale-up green financing”



**G20:** building green  
finance across the G20  
in 2017

**EUROPEAN UNION:**  
EU to develop green finance  
strategy



President of the General  
Assembly initiates high  
level investigation

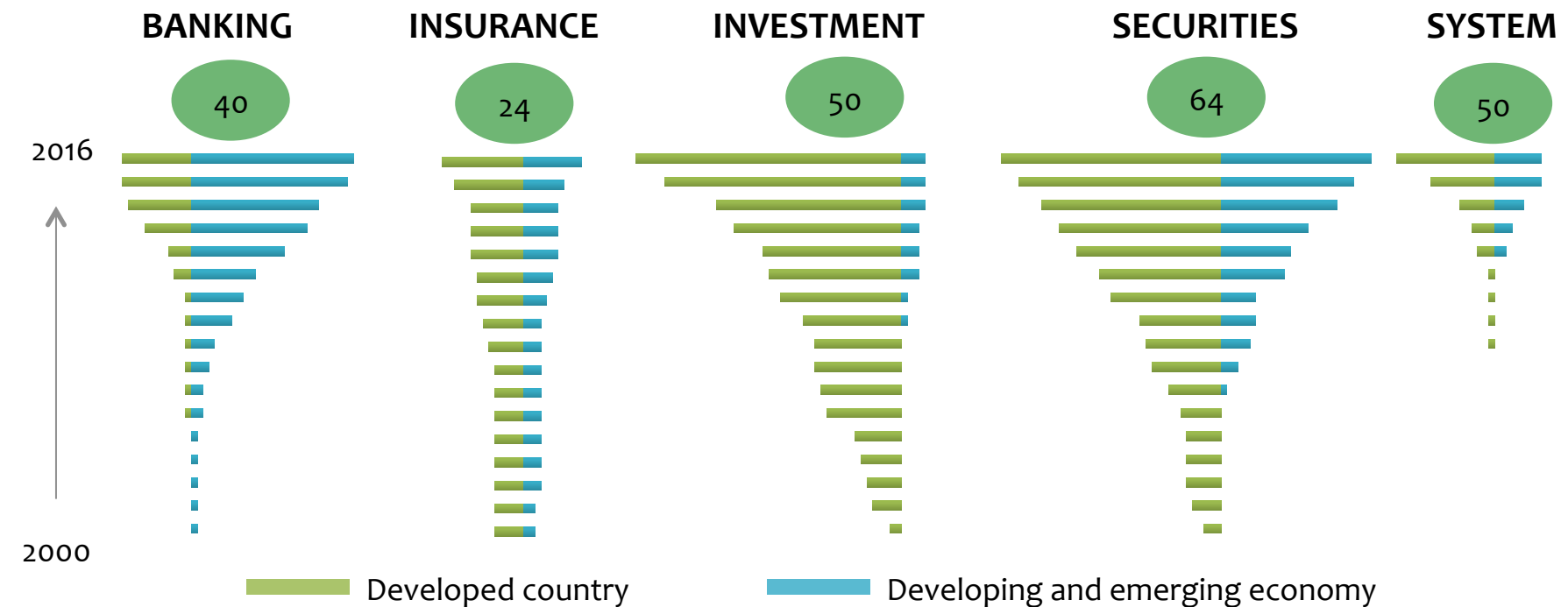
2017?

*“Achieving the SDGs will require mainstream finance. We need to build a new system – that delivers sustainable investment flows, based on both resilient market-based, and robust bank-based, finance.”*  
**Mark Carney, Governor, Bank of England**

# MORE COUNTRIES TAKING ACTION



## OVER 200 POLICY AND REGULATORY MEASURES ACROSS 60 COUNTRIES



**INDONESIA:** Banks to stop credit for coal mining in East Kalimantan

**CHINA:** Pilot for compulsory environmental liability insurance

**AUSTRALIA:** Pensions regulations require ESG risk management

**KAZAKHSTAN:** Voluntary ESG reporting guidelines

**ITALY:** National dialogue on sustainable finance

[Illustrative examples]

*“There is an abundance of capital globally, but governments ... have an important role to play in setting the policies, regulations, incentives, and in ensuring that they are enforced.”*

*Hank M. Paulson, Chair, Paulson Institute*

# MOMENTUM PATHWAYS



## MARKET LEADERSHIP

*Individual and voluntary collective action by market players.*



ICBC publishes first environmental stress test



**GREEN BONDS:** Market growth and standardisation

## NATIONAL ACTION

*Financial policy and regulatory measures and coordination.*



**BRAZIL:** environmental risk in bank regulation.



**SWEDEN:** Budget Bill: Finance sector to serve sustainable development.

## INTERNATIONAL COLLABORATION

*Changes to mandates, supervisory structures and standards*



**FSB:** Task Force on Climate Disclosures



**EU:** Developing green finance strategy

Examples only: not comprehensive

*“I believe that the financial sector as a whole has a generational opportunity to build sustainable capital market”*

*Mark Wilson, Aviva.*

# MOMENTUM: DIMENSIONS OF COLLABORATIVE ACTION



## REALLOCATION OF CAPITAL



**BRAZIL:** Agricultural credit contingent on environmental compliance.



**INDIA:** Priority sector lending to distributed renewables.

## RISK MANAGEMENT



**NETHERLANDS:** DNB review of climate risk.



**UK:** Insurance prudential review of climate risk.

## RESPONSIBILITIES OF INSTITUTIONS



**USA:** Department of Labor recognizes ESG issues as fiduciary factors.



**SOUTH AFRICA:** Code for Responsible Investment in South Africa (CRISA).

## REPORTING AND DISCLOSURE



**FRANCE:** New investor reporting requirements.



**CALIFORNIA:** Fossil fuel disclosure for insurance firms.

## ROADMAPS



**INDONESIA:** OJK Roadmap for Sustainable Finance.



**SWEDEN:** Budget Bill: Finance sector to serve sustainable development.



# MOMENTUM IS NOT ENOUGH



TRANSFORMATIVE CHANGE  
NEEDED IN ECONOMY

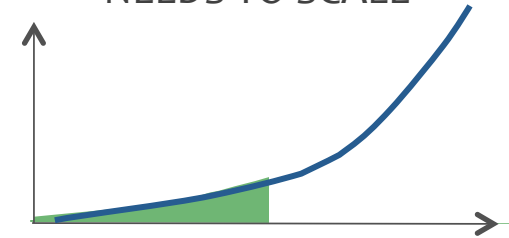


**THE GLOBAL GOALS**  
For Sustainable Development

MOBILISING FINANCE IS  
CRITICAL

**US\$90** TRILLION  
OVER 15 YEARS

SUSTAINABLE FINANCE  
NEEDS TO SCALE



- **One-third** of the world's arable land jeopardised by land degradation.
- **Half** of largest aquifers beyond sustainability tipping point.
- **17%** of the world's population lack access to electricity.

- **US\$260 billion** annual investment gap in agriculture in developing countries.
- **US\$600 billion** needed in green investment in China; only 15% from public sources.

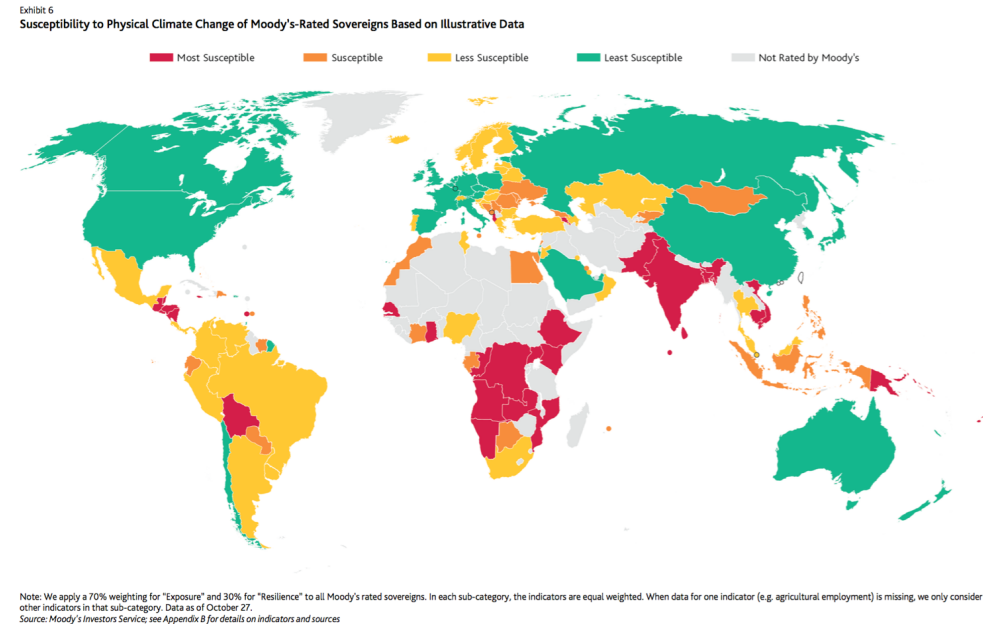
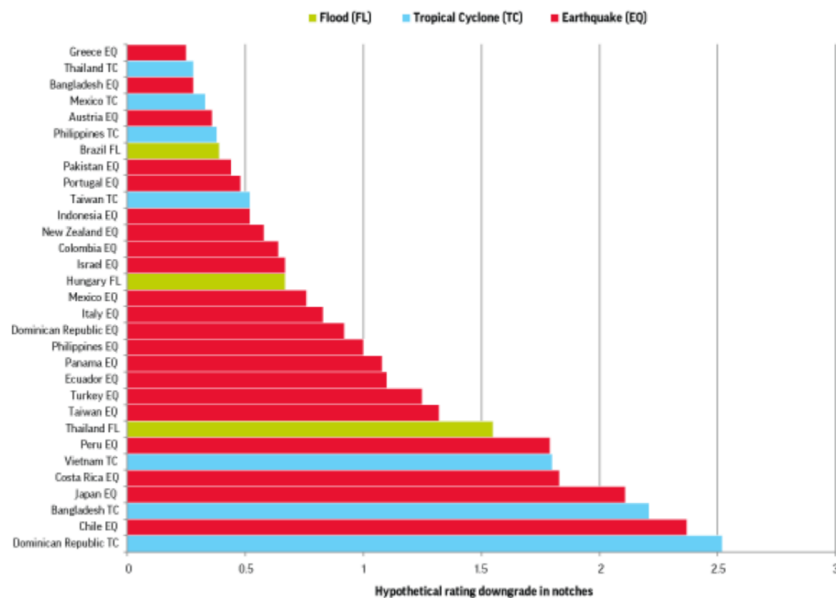
- **Only 5-10%** of bank loans are 'green' in countries where measured.
- **Less than 1%** of total bond issuance is made up of labelled green bonds.

*“Sustainable development is an economic necessity. The SDGs both address risks that threaten our ability to meet our liabilities and also present the opportunity to build the returns that will pay the pensions of ordinary working people.”* **Anne Simpson, Investment Director, CalPERS**

# MANAGING UNINTENDED CONSEQUENCES



- **Threat:** Increasing evidence from rating agencies of country downgrades from environmental factors.
- **Focus:** the interface between macro-economic dimensions of sustainable development, capital markets and long-term investment
- **Actions:** stress testing, policy dialogue & investor engagement

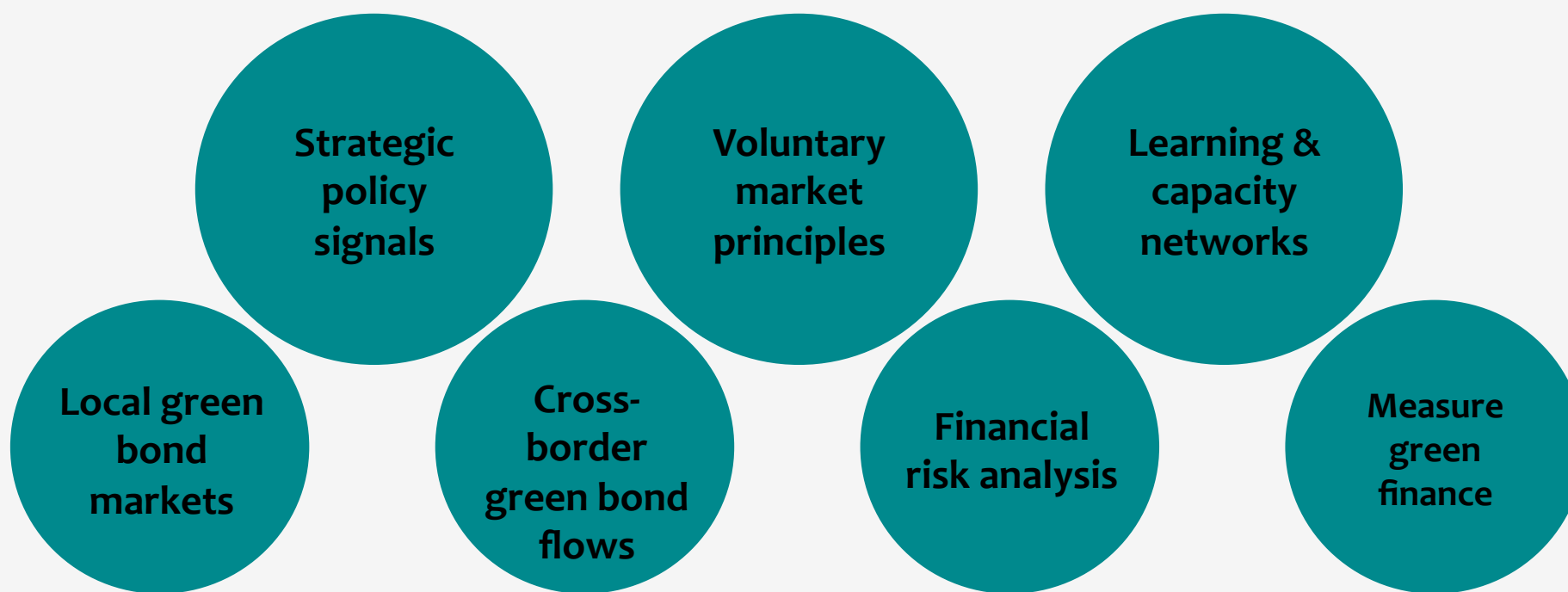


*“As environmental pressures mount, it is important to anticipate the economic impact of these stresses so that countries and investors can work on mitigating and minimizing risk.”*  
**– Achim Steiner, former Executive Director, UNEP**

## SYSTEM DYNAMICS: INTERNATIONAL COOPERATION



**Emerging options** to enhance financial system ability to mobilize private capital for green investment



[Source: G20 Green Finance Synthesis Report]

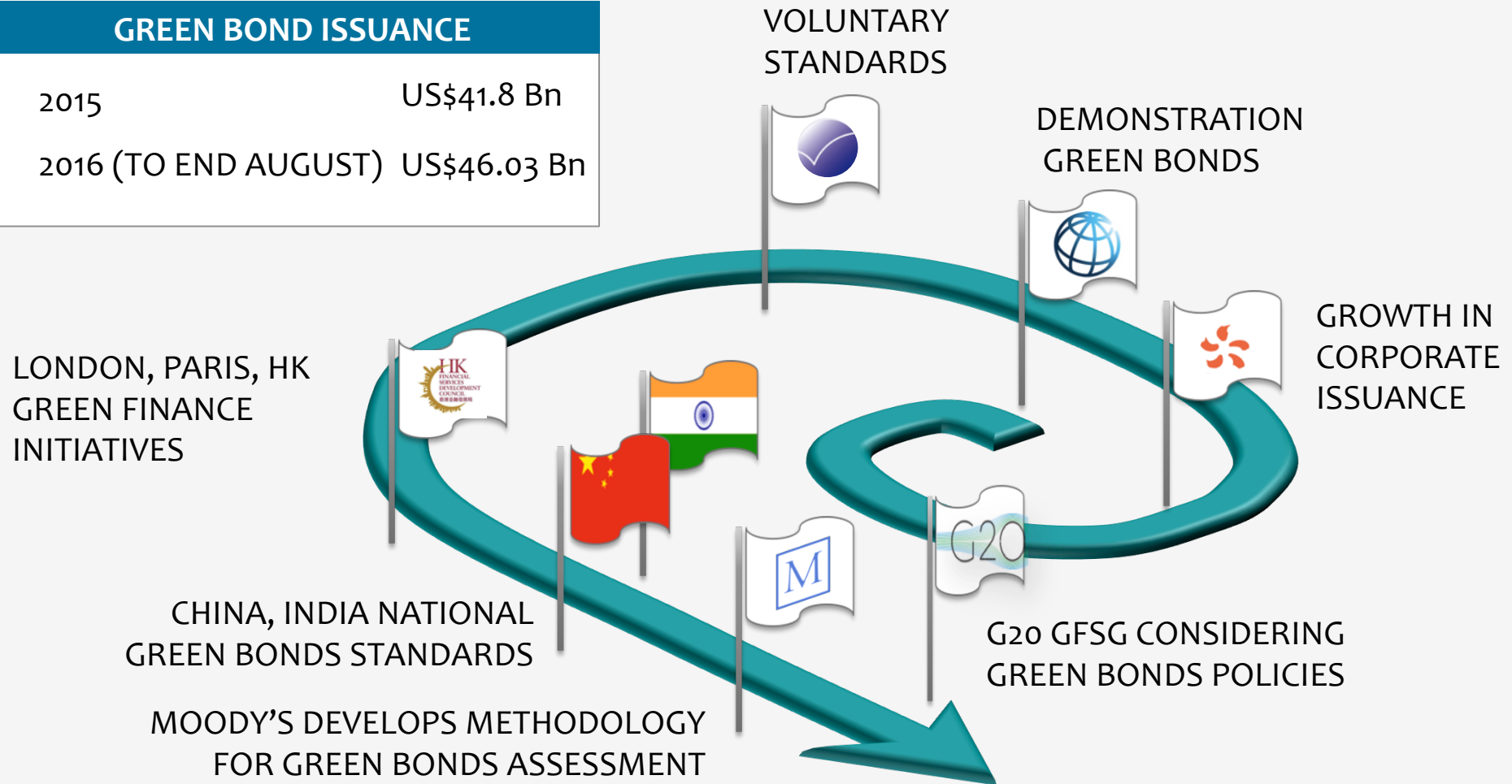
*“There is an opportunity for the G20 to create practical green financing models. The good news is there is an abundance of capital globally, but governments need to create the proper conditions.”*

*Henry M. Paulson Jr., Chairman, Paulson Institute*

# SYSTEM DYNAMICS: ONE THING LEADS TO OTHERS



GREEN BOND ISSUANCE	
2015	US\$41.8 Bn
2016 (TO END AUGUST)	US\$46.03 Bn



*“In China, establishing a green finance system has become a national strategy. In the first quarter of 2016, China was responsible for around 50% of the world's green bond issuance.”*  
**Zhou Xiaochuan, Governor, People's Bank of China**

# SYSTEM DYNAMICS: CONVERGING PATHWAYS



## MAINSTREAM REFORMS

Mainstream reforms stretching existing conventions



- Reporting requirements
- Fiduciary duty
- Prudential regulation

## AVANT GARDE INITIATIVES

Niche initiatives testing novel approaches

PURPOSE



PRI

CHOICE

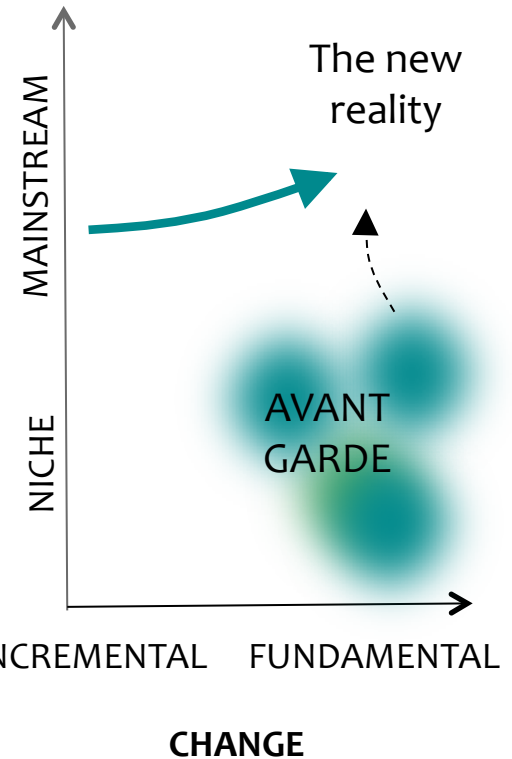


DATA



Dow Jones Sustainability Indexes

## CONVERGENCE



*“Environmental, social and governance factors may have a direct relationship to the value of an investment... these factors are proper components of the fiduciary’s analysis.”*

*US Department of Labor*

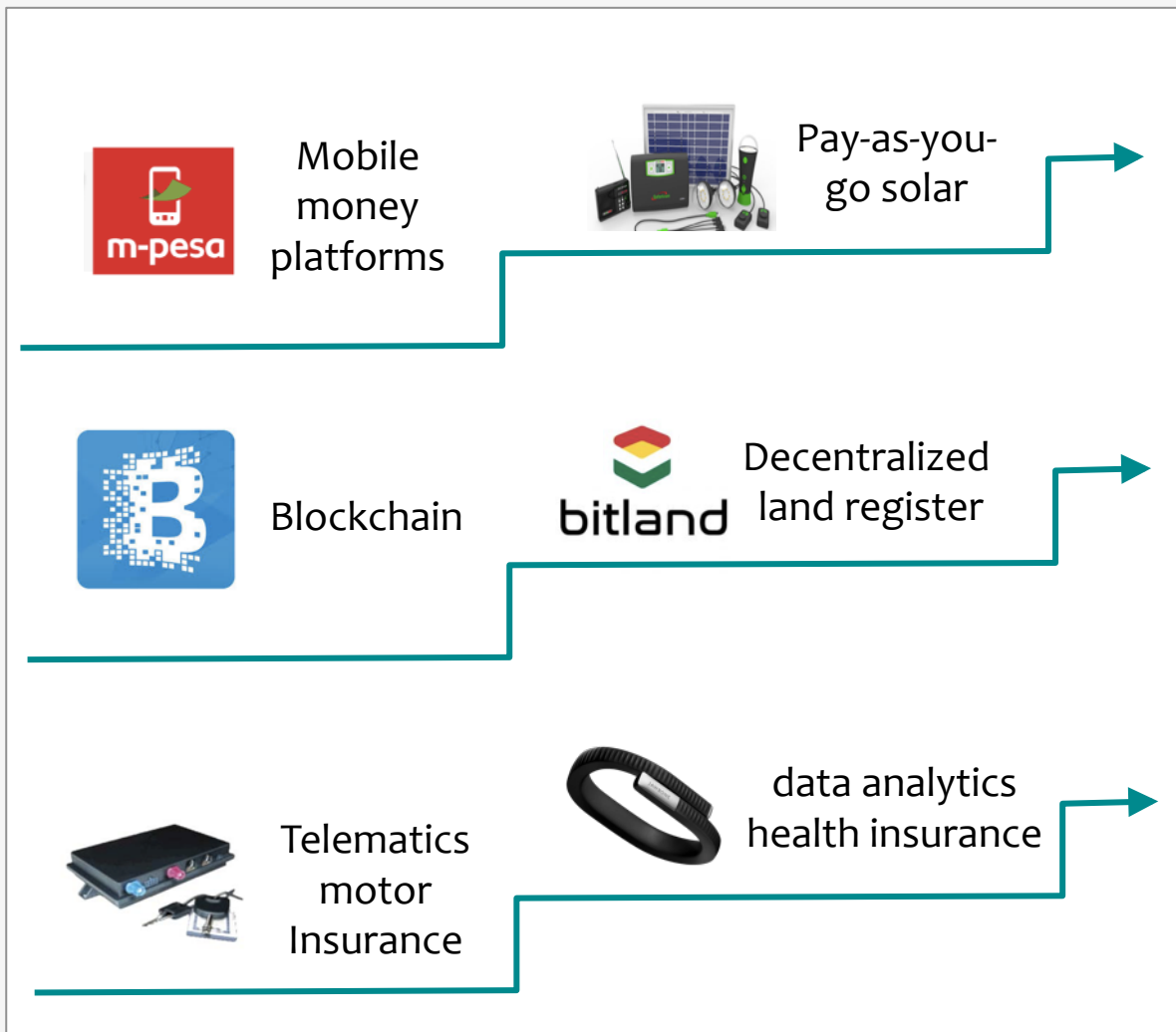
# SYSTEM DYNAMICS: TECHNOLOGY IS A GAME CHANGER



- AUTOMATION – Reduces cost
- DECENTRALIZATION – Increase competition
- BIG DATA – improve risk valuation
- INTERNET OF THINGS – Integrate ‘financial’ and ‘real’ economies



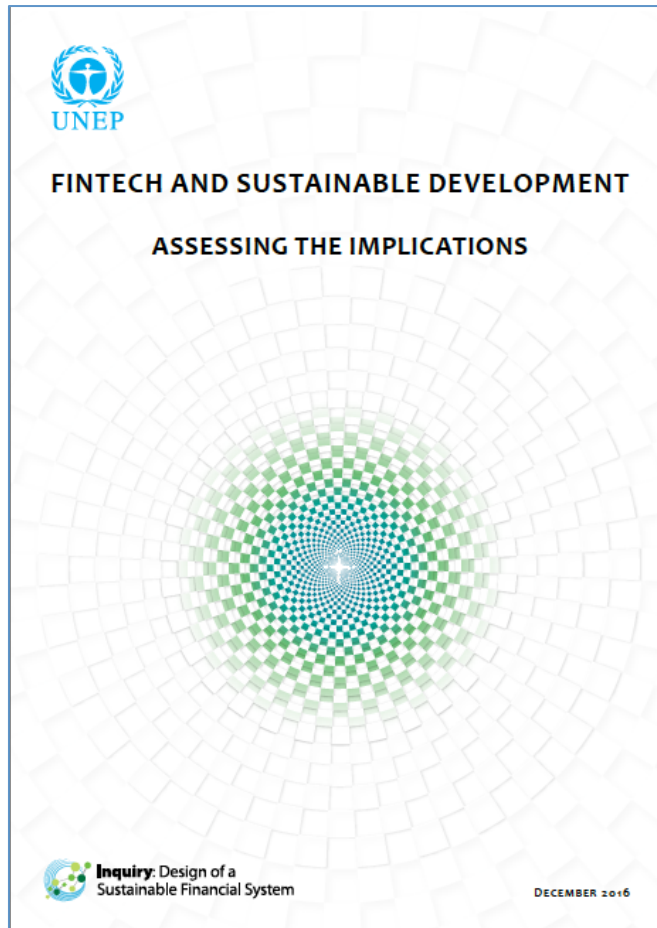
OPPORTUNITY & RISK



*“We always over-estimate the change that will occur in the next two years, and under-estimate the changes that will occur in the next ten. Don’t let yourselves be lulled into inaction”*

*Bill Gates, Bill and Melinda Gates Foundation*

# FINTECH: TRANSFORMATIVE COLLABORATION



## *Green Digital Finance Alliance*

*The United Nations Environment and Ant Financial Services Group will launch in Davos in January, 2017 the Green Digital Finance Alliance to harness digital technologies to catalyze financing that addresses global environmental challenges.*

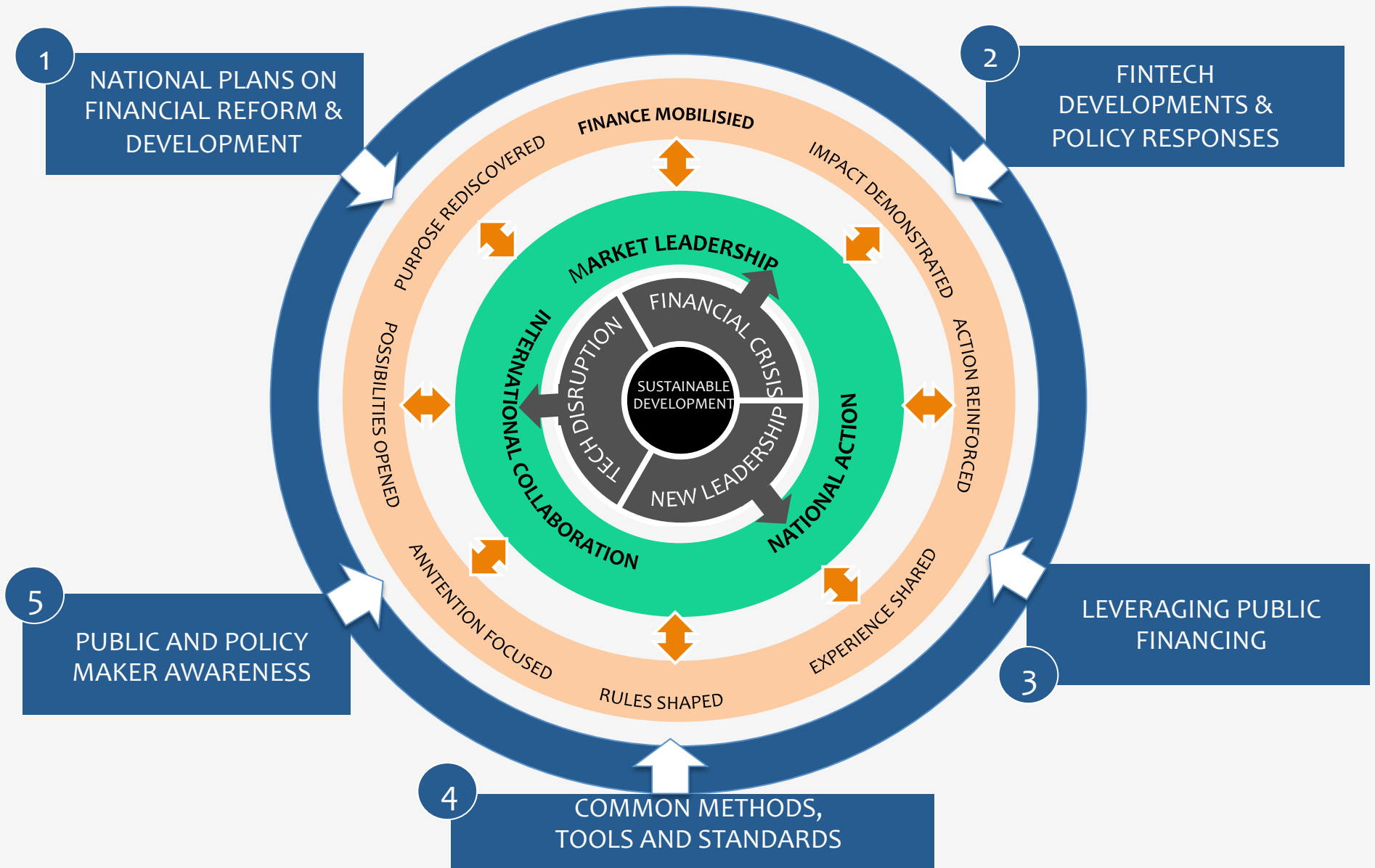
ANT Financial Services is already collaborating with the UN Environment's Inquiry in developing a robust method to provide individual carbon footprints based on transaction data across its 630 million users, and to build associated standards and incentives for carbon savings.

*“Fintech and Sustainable Development”  
an Inquiry Working Paper uniquely examining the potential and risks that fintech represents in  
aligning the financial system with sustainable development  
launched in Stockholm, December 2016*





# FROM MOMENTUM TO TRANSFORMATION





## FIVE STEPS TO TRANSFORMATION



1

### NATIONAL STRATEGIES

Link strategies for financial sector development with plans for SDGs and Paris Agreement implementation.

2

### FINTECH & POLICY RESPONSES

Establish an international coalition to influence the development of codes, standards, regulations and policy.

3

### LEVERAGING PUBLIC FINANCING

Realize a three-fold role: crowding in private capital, creating new markets and pioneering new practices.

4

### AWARENESS & CAPABILITIES

Build awareness and capabilities of financial professionals and policymakers, as well as financial literacy of citizens.

5

### COMMON METHODS, TOOLS & STANDARDS

Develop consistent definitions, methods, tools and standards for capital mobilization, risk and performance assessment.

# INQUIRY IN ACTION: FORWARD LOOKING



- Intergovernmental collaboration**
  - G20 German Presidency
  - G7 Italian Presidency
  - UN President of the General Assembly
  - World bank Group
- Country Engagement**
  - Kenya, India, Mongolia, Morocco, Nigeria, Singapore, European Union
- Research and Innovation**
  - Measuring progress
  - Fintech for Sustainable Development
  - Public finance/subsidies
- Coalitions**
  - Fintech for Sustainable Development
  - Sustainable Insurance Regulators Forum
- Transformation Initiative**
  - Establish Global Learning Platform



## THE INQUIRY: PEOPLE AND INFORMATION



[www.unepinquiry.org](http://www.unepinquiry.org)

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