

# Sustainability and Financial Institutions



"doing it right the first time (and avoiding downstream problems) is the biggest business case"

— Chris Beale, Citigroup, re: adoption of the Equator Principles

"sustainable development means living off the interest the earth provides, not its capital"

— Michael Holtz, Deutsche Bank

## SUSTAINABLE FINANCE

- ▶ Managing environmental and social (E&S) risks in corporate lending and project finance
- ▶ Financial products and services to provide E&S solutions

## WHAT'S NEW

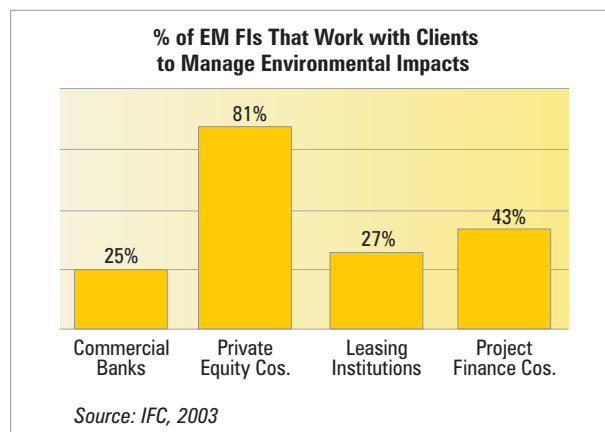
- ▶ World's leading banks adopt "Equator Principles"
- ▶ IFC establishes "sustainable finance" technical assistance facility for financial institutions (FIs) in the emerging markets
- ▶ Global Reporting Initiative and UNEP FI launched a new initiative on sustainability reporting guidelines for FIs
- ▶ Energy efficiency financing expands in Central Europe
- ▶ South Africa's Standard Bank and African Bank both published Sustainability Reports

The financial industry first came to grips with environmental issues in the early 1980s when Superfund legislation<sup>1</sup> placed US banks at risk from pollution cleanup liabilities of corporate borrowers. Twenty years later, the industry — and its many "stakeholders" — has become much more sophisticated about the competitive implications of environmental and social (E&S) issues and the important role of private finance in "sustainable development."

## the brief

In 2003, the agenda is as much about new market opportunities, strategic positioning and good corporate citizenship as it is about risk management and public relations. Environmental awareness and proactive management strategies have spread from the banking sector to all parts of the industry, from insurance companies to investment analysts, though the depth of penetration remains variable and the business case appears to be highly company-specific (see graph). Market leaders, however, are increasingly relating sustainable development to long-term commercial success. Shareholders, customers, regulators and civil society continue to show a growing appetite for assurance and improvements in financial institutions' (FIs') business principles and E&S performance.

E&S concerns are at a critical juncture in the emerging markets (EMs), so they stand to gain the most from innovative financing solutions for sustainable development. As the financial industry expands its activities in EMs, it can influence client behavior and the local economy. FIs are in a unique position to allocate capital for economic growth while simultaneously addressing E&S issues, stimulating new markets, and setting a standard for the international marketplace.



<sup>1</sup> The 1980 US Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) is commonly known as Superfund.



**OPPORTUNITIES**

|                                  |  |   |
|----------------------------------|--|---|
| Added value                      | ▶  | internal capability to manage sustainable development issues  |
|                                  | ▶  | new market share in unconventional industries, underserved populations                                    |
|                                  | ▶  | improved reputation/less negative publicity from NGOs   |
|                                  | ▶  | access to multilateral/bilateral funding, other investments   |
|                                  | ▶  | client retention  |
|                                  | ▶  | market differentiation  |
|                                  | ▶  | lower incidence of legal liability and repayment default  |
| New products/services (examples) | ▶  | lending to underserved urban populations  |
|                                  | ▶  | environmental advisory services   |
|                                  | ▶  | sustainable development funds   |
|                                  | ▶  | financing renewable energy, energy efficiency, ecotourism   |
|                                  | ▶  | investing in fuel cell companies  |
|                                  | ▶  | underwriting climate change mitigation projects   |
|                                  | ▶  | South Africa's Standard Bank provides carbon finance services   |
|                                  | ▶  | 230 Socially Responsible Investment (SRI) funds available in US; 55 SRI funds have EM holdings            |
|                                  | ▶  | Quadris invests in a Brazilian teak plantation that operates according to sustainable forestry guidelines |
|                                  | ▶  | AIA/Thailand gives reduced premiums to businesses that educate employees on HIV/AIDS                      |
| ▶                                | Grameen Bank and Banco Sol offer microenterprise loans |   |

**RISKS**

|                        |   |   |
|------------------------|---|---|
| Informational barriers | ▼ | multiple definitions of sustainability and lack of concrete tools can make it difficult to translate concept into practice  |
|                        | ▼ | “best practices” information may not extend beyond international financial institutions' domain                             |
|                        | ▼ | limited data and lack of transparency   |
|                        | ▼ | no standard way to quantify E&S costs and benefits in EMs   |
|                        | ▼ | insufficient marketplace incentives for sustainability  |
|                        | ▼ | EM FIs were not involved in development of FI guidelines  |
|                        | ▼ | short-term investment horizons ≠ long-term sustainability benefit   |
| Cultural barriers      | ▼ | despite awareness of the issues, many EM FIs feel that solving E&S problems is not their responsibility                     |
|                        | ▼ | shortage of EM policies and legislation designed to stimulate entrepreneurship and sustainable development practices        |
|                        | ▼ | hard to pursue sustainable development where regulation/enforcement is absent or inconsistent                               |
|                        | ▼ | weak regulation/enforcement can spawn informal “regulatory” sector — such ad hoc rules can lead to riskier business climate |
|                        | ▼ | limited domestic demand restricts FIs' use of sustainable development practices as local marketing tool                     |

**THE BOTTOM LINE**

- ▶ embracing sustainable development will be fundamental for FIs that want to be considered world class
- ▶ many value-added opportunities but market not fully equipped to capture them

**FUTURE FORECAST**

- ⌘ external stakeholders, demands of globalization, corporate social responsibility and brand value will be major drivers
- ⌘ banks, asset management, private equity, and microfinance will further ingrain sustainable development; venture capital and insurance companies will pursue more piecemeal efforts

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