# Proud to be green

*Brenda Trenowden explains why the financial sector is embracing sustainability and how it can be used as a force for good in many different areas*

The definition of "sustainability" is "the quality of being able to continue over a period of time". It seems common sense that this should be a central plank in the strategy of any large institution, but sustainability and environmental, social and governance (ESG) issues are fairly recent additions to the mainstream dialogue. They are also very much in vogue, with sustainability and green finance conferences suddenly of great interest to the big banks in particular.

This is partly because, following the financial crisis, the activities of banks and financial services companies have come under increasing scrutiny from regulators, investors, employees, customers and wider society. Engagement with ESG issues presents an opportunity for financial services to improve their image and to be seen to be a force for good.

> *The starting point was the issuance of bonds that finance green projects*

In the UK, there is a revised corporate governance code from the Financial Reporting Council, which puts the relationships between companies, shareholders and other stakeholders at the centre of long-term sustainable growth. There are also requirements from the Prudential Regulation Authority (PRA) and the Financial Conduct Authority on ESG factors. The PRA has launched a consultation on "enhancing banks' and insurers' approaches to managing the financial risks from climate change".

Institutional investors are demanding greater disclosure on ESG issues and the power of investor capital is proving transformational. A recent global survey by HSBC of 1,731 companies and institutional investors revealed that two-thirds of the investors and almost half of the companies have an ESG policy in place. This is not about being cuddly. Financial returns, followed by regulation and tax incentives, were the top three drivers for incorporating ESG into decision-making.

There are many investor initiatives in place to tackle individual aspects of ESG. The 30% Club investor groups are part of the global campaign to address gender imbalance on corporate boards and in executive teams. The 30% Club's UK investor group has 32 investment institutions as members (both asset owners and asset managers), with £11tn of assets under management. There are also large investor groups in Canada and Australia and all three groups engage constructively with the chief executives and chairs of the world's largest listed companies on diversity as an economic and strategic imperative.

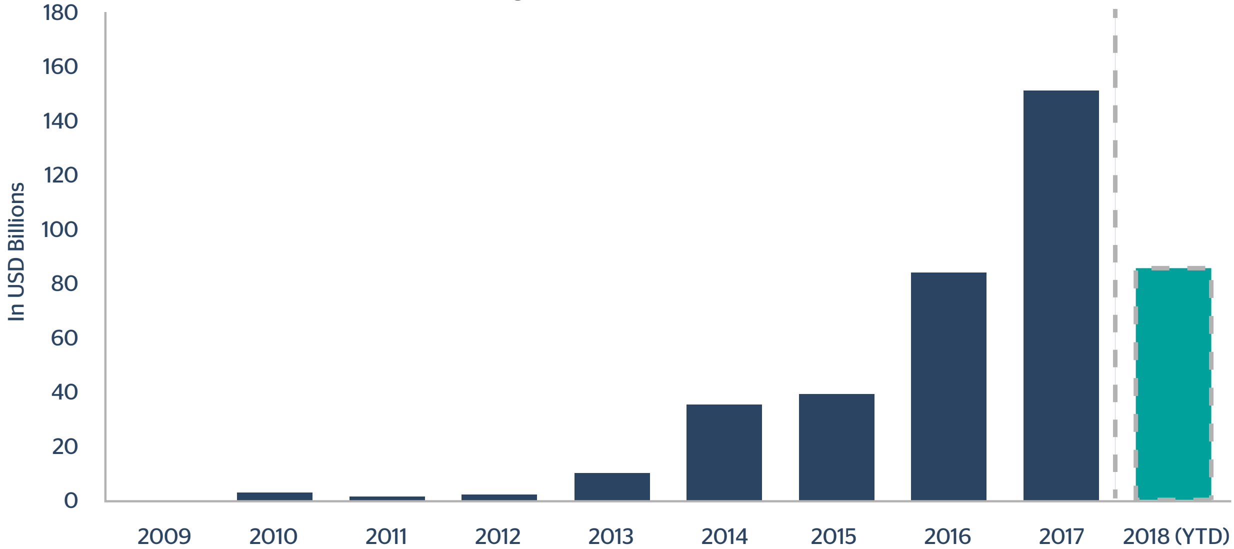
Taking a more encompassing view, the world's leading force for responsible investment is arguably the PRI – the group behind the principles for responsible investment – which is supported by the UN but investor-led ($80tn of assets under management). They have more than 2,000 signatories, one quarter of which are asset owners. Signatories commit to six principles, which are: incorporating ESG issues into investment analysis; being active owners; seeking disclosure on ESG; promoting the acceptance and implementaion of the principles; enhancing their effectiveness; and reporting on activities.

This is not just about trying to do the right thing; it is also driven by necessity. Those institutions that do not innovate and become more sustainable for the long term will be left behind and eventually become obsolete. Financial institutions need to develop tools for analysing the credit and reputational risks of climate change on their portfolio companies so that they can factor them into their models. They also need to consider the wider sustainability issues beyond environmental impacts, such as ethical conduct, employee well-being, transparency, fairness, executive pay, good governance, etc.

But sustainability brings more than costs and challenges. It also presents opportunities. There is a huge amount of investment required to meet the UN's 17 sustainable development goals (SDGs) aimed at solving the world's most pressing sustainable development challenges by 2030.

Financing requirements not yet covered are estimated at anywhere between $1.4tn and $2.5tn. The sector-specific financing requirements for Goal Six alone ("ensure availability and sustainable management of water and sanitation for all"), for example, were estimated by the World Bank at €28bn a year. By 2040, $11tn is forecast to be spent on renewable energy, with renewables expected to generate 36 per cent of electricity globally.

**Total green bond issuance**




*YTD as of April 2018

*Source: Climate Bond Initiative*

There are moves in Australia and New Zealand to convene expert groups, including the banking industry, to make recommendations to government on creating sustainable finance pathways. This is following the models set up in the EU, Canada and the UK. Europe is seen to be leading the way in sustainable finance.

The starting point for green finance was the issuance of green bonds that specifically finance or re-finance green projects. More recently, there have been sustainability bonds directed at the broader list of sustainable developmental

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goals. As a leader in the development of green and sustainable capital markets in the Asia-Pacific region, ANZ, the Australian bank, issued a €750m SDG bond in February 2018, making it only the second bank globally to issue one of this nature. The proceeds will be used to finance or re-finance assets that qualify for nine of the 17 UN SDGs and the paper is a follow up to the bank's A$600m green bond in May 2015.

Several banks have taken this further and are now filling the gap between bonds for rated companies and asset finance for small and medium-sized businesses through "green loans". Green deposits, green mortgages, green asset-backed finance, green trade loans and sustainability "incentive loans" also incentivise borrowers to improve their ESG performance over time. All these products are still in their infancy and much more work is needed in terms of development of a framework, of internationally agreed standards, taxonomy, ratings, measurement and reporting of impacts, etc.

The bottom line is that sustainability is a global issue that transcends borders, sectors and corporate lines. Financial institutions will have an important role to play through the deployment of capital, partnership with their customers and their broader national and international networks. It is an opportunity to be proud to be bankers again. ■

**A special series of articles focusing on sustainability begins on page 12**

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