Sustainable Finance

International Sustainable Finance Centre ISFC

Sustainability & Finance: What does it mean?

Sustainability means meeting our own needs without compromising the ability of **future generations** to meet their own needs. This includes the use of our financial capital, and our economic, social and natural resources.

Finance encompasses management, creation, and study of money and investments. It can be divided into three categories: public finance, corporate finance, and personal finance. In this infographic, we will look into **Corporate** and **Public finance**.

Financial Markets operate as a set of mechanisms to allocate money from investors to projects. Those projects promise a return to the investors, however, they come with a certain amount of risk. The expected **returns and risks** help investors to choose where to invest.

Sustainability in Finance: Investing in the Future

Sustainable Finance refers to the process of taking due account of **Environmental**, **Social** and **Governance** (**ESG**) considerations when making investment decisions in the financial sector. For example:

Does the company use energy efficiently?

Does it avoid deforestation and pollution?

Does it take steps to reduce its emissions and carbon footprint?

Does the company provide its employees with safe and healthy working conditions?

Does it have good relations with local communities?

Does it protect human rights across its supply chains?

What steps has the company taken to prevent corruption?

Does the company have an independent management board?

Does it disclose information clearly? Is it transparent?

E S G in practice:

In addition to the financial aspects, investors evaluate companies using **ESG criteria as a framework** to screen investments and assess risks associated with negative impact.

Good ESG score means that the company has taken steps to mitigate the risks, which has the potential to enhance the overall performance of the investment.

Bad ESG score means that the company is more exposed to risks and, therefore, is less likely to outperform their competition in the long-run.

Sustainability in Investing: The Spectrum

Sustainable investing

Traditionally, investors evaluated performance based on financial measures alone. However, investing with the considerations of environmental or social, non-financial indicators, has become more mainstream in the past decade.

Traditional Investing

Seeks maximisation of returns without considering ESG factors

Responsible Investing

Seeks maximisation of **returns** but uses ESG risk to **screen out harmful** investments (i.e. tobacco, weapons)

Impact Investing

ESG criteria are incorporated in the **decision making** process. Alongside financial returns, the investment should result in positive and **measurable** environmental and social **impact**

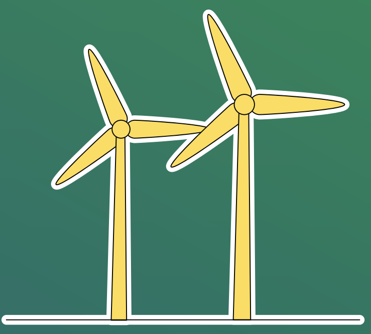
Thematic Investing

Specifically targets businesses that offer **sustainable solutions** to environmental or social topics (i.e. renewable energies, health systems, education)

Philanthropy

Seeks maximisation of positive social and environmental impact without expectations for financial returns

Fixed-income Instruments: Examples



Green Bonds

are fixed-income securities that raise capital for projects with **specific climate and environmental benefits**. For example, renewable energy, energy efficiency projects, pollution prevention, sustainable agriculture, clean water, or mitigation of climate change.

Social Impact Bonds

are used by the **public sector** to raise capital to develop effective **solutions to public-sector problems** and create **better social outcomes**. The repayment of social bonds is often contingent upon **achievement** of the desired outcome, and therefore these bonds come with **higher risk**.

Public Finance

Sustainable Finance: EU Level

In the **context of EU policy,** Sustainable Finance has been identified as a means to support economic growth while **reducing the pressures** on the **environment** and **society.**

Sustainable Finance plays an instrumental role in mobilising the necessary capital to deliver on the policy objectives under the **European Green Deal** and other EU's international commitments on climate and sustainability objectives, such as the **UN's Sustainable Development Goals** and the **Paris Agreement.** In order to help investors better understand which economic activities are environmentally sustainable, the EU has developed a classification tool called **EU Taxonomy.**

Changing Priorities

For some time, sustainability in finance was predominantly considered as part of the **risk assessment** process**.** This is changing, as **regulators** increasingly see it as their responsibility to promote financial practices that have positive societal or environmental impact (or, at least, don't cause harm).

Sustainable Finance in the EU: Milestones

- **Mar 2018** – **EU Commission** publishes action plan for sustainable finance
- **Jun 2019** – The Technical Expert Group (**TEG**) on Sustainable Finance published its first **Report on EU Green Bond Standard**
- **Dec 2019** – **EU Commission** announces the **EU Green Deal**
- **Jan 2020** – The investment pillar of the Green Deal, **Sustainable EU Investment Plan**, is annouced
- **Mar 2020** – The **TEG** publishes its final report on **taxonomy for climate risk mitigation and adaptation**
- **Jun 2020** – **European Parliament** adopts Taxonomy regulation
- **Jul 2020** – EU commits to earmark **30% of its 1.82 trillion EU** budget and recovery fund for **green investments**
- **Dec 2020** – The delegated **act on climate change mitigation and adaptation** under the Taxonomy will be adpoted

National Governments

National governments **set the fiscal policy** and manage the economy and industry by channelling expenditure **(budget)** and setting revenue streams **(taxes).** In this context, governments can also take steps to align their strategy with **global climate goals** and influence responsible and **low-carbon practices** in the private sector.

Mechanisms to achieve this include **SDG tagging, impact assessments, carbon-related financial disclosures** and **carbon taxes.**

Central Banks

Central banks are responsible for setting **monetary policy,** maintaining **financial stability,** and the **regulation of private subjects** (commercial banks, insurance companies, funds). While apolitical by definition, they can use their power to influence **better transparency** and **green practices** in the private sector.

They can deploy **climate-risk stress, testing**, set portfolio **requirements,** or **build capacity** for risk management (training and guidelines)

Sustainable Finance
Why does it matter?

Shifting Paradigms:
Long-term instead of short-term

Sustainable Finance represents a shift in **how finance works** by incorporating considerations about negative **environmental** and **social impact** into the decision-making process and changing the focus from **short-term** to **long-term** goals. It places at its core the **sustainable** use of **materials and natural resources** in a way that satisfies our current needs **without compromising** the needs of the **future generations.**

Financing low-carbon transition:
Private capital meets Public sector

The **transition to a low-carbon economy** is going to be costly as it requires investments in **new technology and infrastructure.** While partly financed by public funds, these budgets alone will not be sufficient to meet the commitment to limit temperature increase to **2°C** and the EU target of **carbon neutrality by 2050.** Sustainable Finance can help **channel private investments** to complement public sector budgets.

Accelerating post-COVID-19 recovery:
Building Back Better

Sustainable Finance **plays a key role in mobilising** the necessary capital for building a resilient economy and ensuring a **sustainable recovery** from the **impacts of the COVID-19 pandemic**. Whether it is Responsible and Impact Investing, Green or Social Bonds, or Green Budgeting, Sustainable Finance offers a **variety of instruments** to direct the necessary capital to where it is **needed the most.**

Identifying future opportunities:
Avoiding being stranded

Sustainable finance **raises awareness** about and help **re-direct** the funds away from so called **stranded assets**, which are assets that will no longer be able to earn an economic return on investment prior to the end of their economic life as a result of **changes in the market** and regulatory environment. This is a crucial aspect of the green transition process, as it ensures that **people's finances (e.g. pensions)** are not lost due to non-sustainable investment strategy.

Financing a just transition:
Building inclusive economies

The transition to a **carbon neutral economy** will greatly affect carbon-intensive sectors (e.g. energy, manufacturing, agriculture), all of which employ millions of people, and which **will need to restructure**. In the past, economic transitions left workers and communities to **bear the costs** of the changes. Sustainable Finance differs from **older paradigms** because of its strong focus on societal outcomes and **people's wellbeing**, ensuring that communities are considered in transition plans. This means the facilitation of training, and the creation of new **employment opportunities** as part of the shift to a decarbonised economy.

Learn more here:

- **European Union:** https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en
- **European Central Bank:** https://www.ecb.europa.eu/ecb/orga/climate/html/index.en.html
- **The World Bank:** https://treasury.worldbank.org/en/about/unit/treasury/client-services/sustainable-finance-advisory
- **Green Finance Platform:** https://greenfinanceplatform.org/
- **Smith School of Enterprise and the Environment** (*Oxford University*): https://www.smithschool.ox.ac.uk/research/sustainable-finance/about.html
- **Grantham Institute** (*LSE*): https://www.lse.ac.uk/granthaminstitute/research-areas/sustainable-finance/
- **Climate Bonds Initiative:** https://www.climatebonds.net/

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