2017: What Next for Green Finance?


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2016 is on course to be not just the hottest on record, but also probably the dirtiest and most hazardous too. "The climate has broken records in 2016" says World Meteorological Organization chief Petteri Taalas. Smog once again returned to haunt many of the world's cities notably in China, Europe and India - with the primary cause the same as climate change: the burning of fossil fuels. Worldwide, around 18,000 people now die every day as a result of air pollution. Some 26 million people are also forced into poverty each year by the impact of natural disasters, with climate shocks reversing hard-won development gains.

The year of green finance

Yet before you get too downhearted, we need to celebrate the fact that 2016 was also the best year ever for green finance. Simply put, green finance covers the financing of investments that generate environmental benefits as part of the broader strategy to achieve inclusive, resilient and sustainable development. In 2016, G20 heads of state for the first time recognized the need to 'scale up green finance' setting out a series of steps to make this happen. Key countries issued strategies for greening their financial systems, with China in the vanguard launching a 35-point programme. Leading insurance regulators also decided to work together on how to respond to sustainability challenges, such as climate change. In all, UN Environment estimates that the number of policy measures to green the financial system has more than doubled to over 200 measures across 60 countries.

Importantly, these policy moves were closely connected with the rapid growth of green finance in the marketplace. The green bond market went from strength to strength, with over US$81 billion in issuance, almost double the 2015 tally.

Financial centres from Casablanca to London, Hong Kong to Paris set out their plans to seize the green finance opportunity, notably by mobilizing the capital required for the low-carbon transition. And the transformational potential of fintech for sustainable development began to be appreciated, from crowdfunding and mobile payments to artificial intelligence.

With global carbon emissions stalling and clean tech costs plummeting, the task ahead for green finance in 2017 is to step up the pace. Financial institutions with assets worth tens of trillions of dollars are now committed to aligning their portfolios with the low-carbon transition and sustainable development more broadly. Yet the actual reallocation of capital still remains insufficient. Amongst the blizzard of opportunities that exist, three practical steps stand out to shift the trillions of private capital: first, rolling out sustainable finance roadmaps at the national level; second, targeting public effort where market forces cannot reach; and third, encouraging a real convergence at the international level in terms of the 'rules of the game' that shape financial markets, such as market standards and financial regulations.

Roadmaps for green and sustainable finance

One of the key insights from the G20's work on green finance on 2016 was that governments need to be clearer about the policy signals they send to financiers about their plans for climate action and sustainable development. With the Paris Agreement now in force, the focus in 2017 will shift to how the Nationally Determined Contributions (NDCs) that set out each country's goals can be turned into clear investment pipelines. Insurance giant Aviva calls these 'capital raising plans', covering both climate and broader sustainability goals; others call them 'climate investment plans'. Whatever the precise terminology, what is key to these roadmaps is making the bridge between high-level national targets and the technical details of how money actually flows across banking, capital markets, insurance and investment.

To do this requires an open and sustained conversation in each country to work through the opportunities, the bottlenecks and the priorities for national action. A number of countries are already moving ahead. At COP22, Morocco's central bank launched its roadmap for the finance sector, pinpointing five priority areas: innovative financial instruments, better risk governance, stronger financial inclusion, capacity building and improved transparency. Throughout 2016, Italy has engaged in a national dialogue on sustainable finance; the results will be released in early February. The European Union is also drawing up a comprehensive strategy on sustainable finance as part of its Capital Markets Union, supported by a high-level expert group. And Mexico is also moving ahead with the design of a green finance strategy to implement its NDC.

What needs to happen now is to ensure that the mobilization of green finance becomes a core part not just of the wider implementation of the NDCs - through initiatives such as the NDC Partnership - but also part of mainstream plans for financial sector development. If we are successful, then we could have a critical mass of countries, both developed and developing, with roadmaps in place by the time of the next global climate conference (COP23), which takes place in November 2017. This would signal to the world of finance that the goal of the Paris Agreement to make financial flows 'climate consistent' had become both practical and bankable.

Crowding in private capital

We know that the vast bulk of green and climate finance will come from the private sector. But experience has also shown that without a combination of public finance and policy frameworks, capital will often not flow. This is especially the case in developing countries, where many key financial markets are still missing and where governments shape a large share of capital deployment through state-owned financial institutions, development banks and policy-directed lending. This leads to the second priority for 2017: targeting public effort where market forces cannot reach.

The lessons flowing from the ramp-up in renewables shows what now needs to happen with other green finance priorities, notably energy efficiency and adaptation. Temporary and targeted incentives (such as feed-in tariffs) along with focused risk mitigation tools can help to overcome investor concerns with these new sectors and themes. International flows of public finance are critical here. Industrialized countries have extended their commitment to mobilize US$100 billion of climate finance each year for developing countries by 2020. Latest estimates suggest that actual flows of climate finance into developing countries rose from US$52 billion in 2013 to US$62 billion in 2014, with pledges made in 2015 set to take public flows alone to US$67 billion in 2020. As well as using scarce public money to pump-prime the investment shift, the public sector can also help to make markets not just by issuing green assets - as leading development finance institutions have done in the case of bonds - but also by buying them, so that they form a standard part of central bank balance sheets, for example.

International cooperation on rules of the game

Central banks, finance ministries and regulators are starting to make sustainability factors a routine part of financial practice through measures to build competence and strengthen accountability. Here, international cooperation is important to share emerging experience and ensure that there is a convergence on key rules of the game - the third priority for 2017. What is striking about the breakthroughs made in 2016 was how countries observed what others were doing - and then put in place measures to boost national action that were aligned with international best practice. China and India's regulations to drive their green bond markets are prime examples, building on international norms in the Green Bond Principles and

Climate Bond Standards.

Insurance is another area where both financial institutions and financial regulators are moving ahead with common approaches. Closing the growing protection gap between the economic and insured losses from natural hazards is a growing concern, a gap that will be widened with climate change. On the back of the long-standing Principles for Sustainable Insurance for firms, the new Sustainable Insurance Forum is designed to promote cooperation on critical challenges facing supervisors, such as climate change. Co-hosted by the California Department of Insurance and UN Environment, the Forum's first meeting in December included insurance supervisors and regulators from Brazil, California, France, Ghana, Jamaica, Morocco, the Netherlands, Singapore and the UK, as well as the International Association of Insurance Supervisors. Heading into 2017, the Forum will focus on disclosure, access to insurance, sustainable insurance roadmaps, climate risk, disaster risk reduction and capacity building for supervisors.

Again and again, measurement emerges as a core priority for international convergence. Here, the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) shows how an industry-led process can provide in short order globally relevant guidance for consistent reporting by both corporations and financial institutions. Significantly, the recommendations of the TCFD broke new ground by underscoring the critical importance of forward-looking disclosures as well as reporting on past performance. In addition, the Task Force put disclosure by financial institutions squarely on the table alongside reporting by business and industry. Better reporting by banks, investors and insurance firms on the risks and opportunities they face will help close the information loop and improve the quality of data across the system. The TCFD's recommendations are still open for consultation until 12 February, with an updated report delivered to the FSB in June. Effective disclosure rests on clear and credible analytical tools, which is why making the financial risks flowing from environmental factors more transparent - and presenting options to reduce them - will be a priority theme of the G20 Green Finance Study Group under Germany's Presidency in 2017.

Getting critical mass on measuring green finance flows across sectors and asset classes is also vital to market expansion. The mix of principles and standards in the green bond market has shown what can be done to build a clear and trusted approach. This now needs to be extended upstream into bank balance sheets through tagging loans with environmental markers, starting with housing and project finance. It also needs to move sideways into the world's equity markets, where some institutions such as FTSE in London are already tracking the green revenues of listed companies. Making sure we have a joined-up map of green finance flows will be critical both to avoid 'greenwashing' and also to target extra policy action where it is needed.

Improved disclosure and measurement are a means to achieve the ultimate goal of capital allocation aligned to climate and sustainability goals. Already more and more financial institutions are taking action to reduce the carbon footprints of their portfolios and assign more capital to green assets. Launched in 2014, the Portfolio Decarbonization Coalition, for example, now brings together 27 international investors with more than US$3 trillion in assets. The key lesson from its experience to date is that “portfolio decarbonization offers real benefits, both in terms of reducing a portfolio’s carbon impact but also in terms of financial performance”. As a result, 2017 will see more and more investors taking measurable action.

The linkages between fintech and green finance are at an even earlier phase of evolution - but with digitization now revolutionizing the way that financial services are delivered, it perhaps has even greater potential. As yet, the core standards have not been set. This is why the ANT Financial Services Group and UN Environment are launching a new international partnership during World Economic Forum’s Annual Meeting in Davos. The Green Digital Finance Alliance will bring together financial institutions committed to using digital technology to advance green finance in lending, investment and insurance. These new financial services can shape citizens’ behaviour in ways that positively impact the environment. A case in point is ANT’s early experimentation in linking financial transaction and carbon footprint data, and then providing social media and carbon offset incentives to encourage carbon-light living.

There is no doubt that considerable uncertainty clouds the year ahead. But one thing is clear - the shift to climate-consistent, green and, ultimately, more sustainable finance now looks unstoppable.

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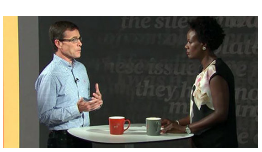

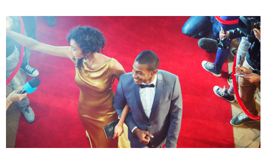

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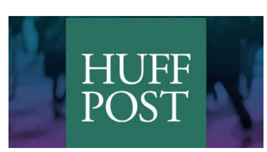

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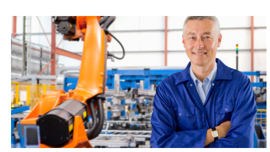

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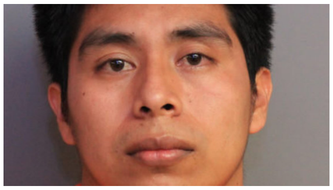

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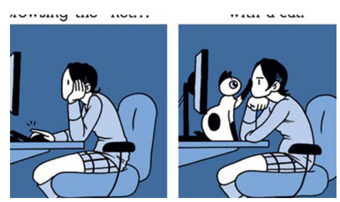

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