

Introduction

There are many who argue that a stable and secure financial system underpinning opportunities for wealth creation is a necessary (though perhaps not sufficient) condition to create the 'space' for nations, states, regions, local communities and individuals to engage with issues such as environmental protection and social equality. Sidestepping the philosophical debate, sustainable finance is seen as a global public good that can make a positive contribution to sustainability outcomes.

Sustainable finance aims to both create global financial security and deliver global sustainability outcomes by achieving poverty eradication, social equality, environmental sustainability and economic growth. Systemic changes in the operation of markets are required in order to achieve sustainable finance, such as internalising the consequential social, economic and environmental impacts arising from financial crises, and accounting for the attendant risks of financial development that are placed on poor communities and the environment, especially amongst developing nations.

This briefing note discusses the difference between sustainable finance and financing sustainability; outlines the need for global financial security; presents an overview of some of the major sustainability initiatives in the financial sector, including superannuation choices in Australia; and questions what responsibilities providers of finance should bear.

Financing Sustainability vs. Sustainable Finance

Sustainable finance is distinct from financing sustainability. Financing sustainability is about finding the funds for projects that achieve sustainable outcomes, which presents as a major global challenge. For example, costs of conserving biodiversity through establishing and maintaining a global reserve system are estimated at around US\$30 billion per year, five times that which is currently spent [4].

While there may be overlapping themes and mechanisms, sustainable finance attempts to address systemic barriers to achieving global financial security as opposed to the direct financing of projects. Priorities for sustainable finance include strengthening the architecture of the international financial system through increased governance and transparency, developing internationally accepted standards, improving internal practices and procedures within the financial sector, improving risk assessment and management within the private sector and undertaking new initiatives for the prevention of financial crises [7].

Global Financial Security

Around the globe there is increased integration of national financial markets. This interconnection, in combination with financial crises ('contagious' disruption to financial markets associated with falling asset prices and high levels of insolvency) and market inefficiencies, has resulted in growing potential for economic instability, particularly amongst the poorest countries, both within and between their borders [2].

The current widespread climate of short-term market volatility, questionable corporate governance, weak inclusion of environmental and social impacts in market prices, debt imbalance with global Gross National Product, minimal official development assistance, and the misdirection of foreign direct investment, contribute to the risk of long-term financial insecurity. This in turn increases the likelihood and rate of occurrence of financial crises across the globe [1].

The consequential impacts of financial crises and risk on poor communities and the environment, especially in developing countries, are not taken into account by markets. The social costs of this insecurity relate to increased unemployment levels amongst already poor and marginalised sectors of community, for example unskilled workers, and reduced standards of living with associated increases in absolute levels of poverty. The environmental costs of such crises revolve around the potential for accelerated environmental pollution, natural resource depletion and ecosystem degradation, as greater priority is given to economic growth [1].

With the interconnectedness of markets and the impacts of financial risk and crises on poor communities and the environment, the goal of global financial security is a key feature of the sustainability agenda. Financial insecurity can be viewed as a global public bad with 'disbenefits' that are shared by affected countries and communities (non-excludable), and with a continuing ongoing negative impact that does not 'wear out' (non-rival) [2]. Initiatives aimed at reducing and/or removing these 'bads' are presented in the following section.

Overview of Sustainable Finance Initiatives

There are a number of current activities aimed at supporting sustainable finance. These include United Nations Environment Programme Finance Initiative, Equator Principles, Socially Responsible Investing (SRI), Global Reporting Initiative (GRI), Jubilee Plus, Heavily Indebted Poor Countries (HIPC) Initiative, Foreign Private Capital Capacity Building Programme (FPC CBP), Investment in Social Capital and various superannuation products. These are explored in further detail below.

United Nations Environment Programme Finance Initiative (UNEP FI)

United Nations Environment Programme Finance Initiative (UNEP FI) is a global partnership between UNEP and the financial (including insurance) sector that aims to understand the impacts of environmental and social considerations on financial performance. Every financial institution joining up to UNEP FI signs an aspirational statement committing them to integrating environmental considerations into all aspects of their business.¹ In addition to a commitment to sustainable development, signatories undertake to both adopt a best practice and continuous improvement approach to environmental management and to share information in a manner that raises public awareness and improves communication with stakeholders regarding environmental protection and sustainable development.

Equator Principles

The Equator Principles were developed by International Finance Corporation (IFC - the trading arm of World Bank) and are a framework for financial institutions to manage environmental and social issues in project financing so that projects are 'socially responsible and reflect sound environmental management practices.' The thirty-five 'Equator Banks' currently signed up to the programme commit to applying IFC's environmental and social policies to projects over US\$50 million.²

Each project is classified as Category A, B or C depending on the potential for 'significant adverse environmental impacts that are sensitive, diverse, or unprecedented' and the area of potential impact, for example site specific or beyond business boundaries. For Category B and C projects, the borrower must undertake an Environmental Assessment (EA) with reference to World Bank and IFC Pollution Prevention and Abatement Guidelines and Safeguard Policies in addition to stakeholder consultation, and then prepare an Environmental Management Plan (EMP) that includes mitigation, action plans, monitoring, management of risk and schedules.

Socially Responsible Investing (SRI)

Socially Responsible Investing (SRI), also known as ethical investment or sustainable investment, refers to the inclusion of non-financial 'values' criteria such as social justice, peace and a healthy environment, into investment decisions. SRI is achieved by 'screening' investments on the basis of performance against select environmental or social criteria. There are three types of screening: negative screens that exclude undesirable activities, for example gambling; positive screens that seek to encourage businesses with positive environmental or social outcomes such as renewable energy; and best-of-sector screens that operate across all industry sectors but differentiate on the basis of benchmarked best-performance on environmental and social issues within that sector [4].

Examples of company rating tools, based on social responsibility screens and developed to assist personal and institutional investors, include the Dow Jones Sustainability Indexes, Reputex Social Responsibility Ratings and FTSE4GOOD.³ These tools measure performance across criteria such as corporate governance, codes of conduct, workplace policies, environmental and social impacts of company products and services and reporting of these impacts, human capital development and stakeholder engagement.

¹ For more information on United Nations Environment Programme Finance Initiative (UNEP FI) statements of commitment visit <http://www.unepfi.org/signatories/statements/index.html>.

² For more information on IFC environmental and social policies visit <http://www.equator-principles.com>.

³ For more information visit <http://www.sustainability-indexes.com>, <http://www.reputex.com.au> and <http://www.ftse.com/ftse4good> respectively

Global Reporting Initiative (GRI)

Global Reporting Initiative (GRI) is an independent organisation, convened by the Coalition for Environmentally Responsible Economies (CERES) and UNEP in 1997 to develop a globally applicable set of Sustainability Reporting Guidelines for organisations disclosing the economic, environmental and social performance of their activities, products and services. These Guidelines were developed through the active participation of more than 5,000 individual stakeholders from over 80 countries and across all sectors of the economy. The Guidelines are augmented by both technical protocols that explore the measurement of economic, environmental and social indicators in greater detail than the Guidelines, and industry sector supplements, which give additional guidance on sector specific reporting issues.⁴

Jubilee Plus

Jubilee 2000 was an international campaign coordinated across 60 countries that pressured the G7 leaders from the United Kingdom, the United States of America, France, Canada, Italy, Japan and Germany to undertake a fair and transparent process of cancelling the unpayable debts of the poorest countries in the world by the year 2000. Jubilee 2000 succeeded in gaining commitments to writing off \$100 billion in debt, but at the end of the campaign an ongoing commitment was required for the establishment of an 'international financial system which fosters and supports the achievement of economic and social rights, including the eradication of poverty, in a framework of sustainability, equity and self-reliance.' Jubilee Plus refers to campaigns continuing the work of Jubilee 2000 to cancel third-world nation debt and create a more equitable international financial system. Organisations include UK's Jubilee Debt Campaign, Jubilee USA and Jubilee Movement International (JMI).⁵

Heavily Indebted Poor Countries (HIPC) Initiative

Heavily Indebted Poor Countries (HIPC) Initiative was developed by the World Bank and International Monetary Fund in 1996 as an attempt to reduce the debt of the world's most heavily indebted countries. Those countries facing an 'unsustainable debt situation' (essentially where the country does not raise enough revenue through exports to service their existing levels of debt), are eligible to receive debt relief funding through the HIPC Trust Fund and in return commit to integrated poverty reduction and economic reform programmes.⁶

Foreign Private Capital - Capacity Building Programme (FPC CBP)

Foreign Private Capital - Capacity Building Programme (FPC CBP) was developed by five international finance institutions to support governments in developing countries to build capacity to monitor and analyse the effects of foreign private capital on their economies; facilitate the design of effective policy responses to manage these effects; and promote sustainable development. Founding institutions include Banque Centrale des Etats de l'Afrique de l'Ouest, Centro de Estudios Monetarios Latinoamericanos, Development Finance International, Macroeconomic and Financial Management Institute of East and Southern Africa and West African Institute for Financial and Economic Management.⁷

Australian Superannuation – Super Choice

Many countries require some form of contribution to personal pension plans. In Australia this is known as the Superannuation Guarantee, which requires employers to make superannuation contributions on behalf of eligible employees (eligibility is usually determined on the amount of hours worked, the wage paid and status of employment).

From 1 July 2005 eligible employees in the Australian workforce are able to choose where compulsory payments made by their employer are invested. The 'choice' eligibility criteria exclude those employees working under Certified Agreements, Australian Workplace Agreements, some Public Sector Employees and certain Deemed Benefit Fund Members [6]. This means that employees will control where tens of billions of dollars in annual contributions are invested [8], creating the potential for all Australians to invest in SRI superannuation funds.

⁴ For more information on the Global Reporting Initiative visit <http://www.globalreporting.org>, and also see WISE Briefing Note 4-1 2004 on the Global Reporting Initiative.

⁵ More information on Jubilee Plus activities can be found at <http://www.jubileeplus.org>

⁶ For more information on the approach to calculating unsustainable debt and on progress to date visit <http://www.worldbank.org/hipc/about/hipcbr/hipcbr.htm>.

⁷ For more information on FBC CBP programmes and progress visit <http://www.fpc-cbp.org>.

Responsibilities for Finance Providers

Embedded within the sustainable finance debate is the question of how much responsibility finance providers should accept for issues up-and-down the financial 'supply chain'. Concerns regarding money laundering or other 'dirty profits' on the supply side and financing conflict or terrorist activities or even unsustainable business on the demand side highlight the potential conflict between providing the highest possible return to investors and the demands of socially responsible investment [2].

Finance providers are asked to consider a variety of indicators when undertaking financial assessment including social indicators (gender, education, health, equality and institutional ratification of international agreements), economic indicators (income, national risk, employment and observance of financial supervision and regulation) and environmental indicators (natural resource use and quality, biodiversity and ratification of multilateral environmental agreements) [1].

The degree to which investors should be held to account over the use of their funds remains a contentious point. Recent outrage over acts of terrorism and attempts to prosecute those individuals and institutions providing financial support to the perpetrators of these atrocities is an argument in favour of 'down stream' accountability. The application of this thinking to other sustainability related issues such as environmental protection is likely to be even more problematic, but with far reaching implications, which could include allocating proportional liability to investors unsustainable activities in tobacco, asbestos, gambling and greenhouse gas intensive industries.

Useful References

1. Gardiner, R. (2001), 'Sustainable Finance Briefing Paper', Earth Summit 2002, found online at <http://www.earthsummit2002.org/es/issues/susfin/susfin.PDF>, accessed October 2005.
2. Gardiner, R. and Le Goulven, K. (2001), 'Global Public Goods Briefing Paper' Earth Summit 2002, found online at <http://www.earthsummit2002.org/es/issues/GPG/gpg.htm>, accessed October 2005.
3. Bray, J., Switzer, J. Hussels, M., Wagner, D. and Kelly, M. (2004), 'Investing in Stability: Conflict Risk, Environmental Challenges and the Bottom-Line – Summary Report', UNEP Finance Initiative, found online at http://www.unepfi.org/fileadmin/documents/investing_in_stability_final_report_2004.pdf, accessed October 2005.
4. CFA (2003), 'Building a Secure Financial Future: Finance & Resources - Vth IUCN World Parks Congress Durban, South Africa, September 8–17, 2003, found online at http://www.conservationfinance.org/WPC/WPC_documents/WPC_Sustainable_Finance_v8.pdf, accessed October 2005.
5. Monash Sustainability Enterprises and KPMG (2001), 'Socially Responsible Investment: Your Questions Answered - An Information Guide for Superannuation Trustees and Fund Managers', Department of Environment and Heritage, found online at <http://www.deh.gov.au/settlements/industry/finance/publications/respon-investment.html>, accessed October 2005.
6. Australian Government (2005), 'Super Choices', found online at [http://fido ASIC.gov.au/ASIC/pdflib.nsf/LookupByFileName/Super_Choices.pdf/\\$file/Super_Choices.pdf](http://fido ASIC.gov.au/ASIC/pdflib.nsf/LookupByFileName/Super_Choices.pdf/$file/Super_Choices.pdf), accessed October 2005.
7. IMF (2000), 'Progress in Strengthening the Architecture of the International Financial System', International Monetary Fund, found online at <http://www.imf.org/external/np/exr/facts/arcguide.htm>, accessed October 2005.
8. APRA (2004), 'Media Releases - APRA statistics reveal superannuation assets close to \$700 billion', Australian Prudential Regulation Authority, found online at http://www.apra.gov.au/media-releases/05_24.cfm, accessed October 2005.

Contact WISE Briefing Notes

PO Box 705
Glebe NSW AUSTRALIA 2037
W: www.wisebriefingnotes.com

T: +61 2 9571 4901
F: +61 2 9571 4900
E: wise@wisebriefingnotes.com

