

Mobilising the financial sector for a sustainable future

Mapping existing approaches to promote social and environmental sustainability goals in the financial sector



Myriam Vander Stichele

Colophon

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October 2015

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The Centre for Research on Multinational Corporations (SOMO) is an independent, not-for-profit research and network organisation working on social, ecological and economic issues related to sustainable development. Since 1973, the organisation investigates multinational corporations and the consequences of their activities for people and the environment around the world.



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Amsterdam, October 2015

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Acronyms

CDP	Carbon Disclosure Project
CRA	Credit Rating agency
CSO	Civil society organisation
DFI	Development finance institution
ECA	Export Credit Agency
ESG	Economic, social and governance
FSB	Financial Stability Board
FSC	Financial Services Charter (South Africa)
GABV	Global Alliance for Banking on Values
G20	Multilateral platform of decision making by 19 countries with the largest economies, and the EU
IFC	International Finance Corporation
ILO	International Labour Organization
IMF	International Monetary Fund
MDGs	Millennium Development Goals
NGO	Non-governmental organisation
OECD	Organisation for Economic Co-operation and Development
SDGs	Sustainable Development Goals
SME	Small- and medium-sized enterprise
SRI	Socially Responsible Investment
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNEP	United Nations Environment Programme
UNEP FI	United Nations Environment Programme Finance Initiative
UNEP PRI	United Nations Principles for Responsible Investment
UNFCCC	United Nations Framework Convention on Climate Change

Introduction

Global recognition is increasing that our world is facing growing environmental, social and economic crises. In the context of crucial agenda-setting moments in 2015, including the Third UN Financing for Development agreement (in July 2015), the new UN Sustainable Development Goals (September 2015) and the December 2015 meeting of COP21 (conference to the Parties of the UN Framework Convention on Climate Change (UNFCCC)), the incorporation of social and environmental aspects into the financial sector is increasingly being raised as a response to environmental and social crises. Such a response brings together, according to the United Nations Environment Programme (UNEP), ‘three hitherto largely disconnected agendas: the growing environmental and equity imperative, the financing needs of the inclusive, green economy, and the financial market development agenda’.¹ Although a comprehensive alternative view of the role of the finance system in society has hardly been developed, many alternative proposals, initiatives, approaches and some practices have been and are being developing as documented in this report.

This report provides an insight into the search for a financial system that is not only financially stable – which has been a focus of many recent financial reforms – but one that serves the needs of societies and economies that develop in an equitable, inclusive and environmentally sustainable way. UNEP Inquiry defines a ‘sustainable financial system’ as one that ‘creates, values, and transacts financial assets, in ways that shape real wealth to serve the long-term needs of an inclusive, environmentally sustainable economy’.² In addition, such financial system should be at the service of (the transition to) sustainable societies.

The goal of this report goal is to provide a mapping and broad but not complete overview of initiatives that aim to incorporate environmental and social sustainability aspects within the financial sector. These aspects are often referred to as social, environmental and governance (ESG) issues. This report not only attempts to map what initiatives exist but also tries to identify the different approaches, or ‘strategies’, that are used on how to integrate social and environmental sustainability aspects in the financial sector. In addition, the report raises a few critical questions about the existing approaches taken. Each chapter in this report is therefore divided up according to the approaches or ‘strategies’, such as:

- ▣ mandatory regulations
- ▣ policies and incentives
- ▣ voluntary measures
- ▣ financial industry alternatives
- ▣ citizens’ advocacy and campaigns

1 UNEP Inquiry, *Aligning the Financial System with Sustainable Development – An Invitation*, June 2014, www.unep.org/greeneconomy/financialinquiry/Portals/50215/Inquiry_summary_final%20June%202014.pdf (viewed 10 July 2014).

2 UNEP Inquiry, *The financial system we need – Aligning the financial system with sustainable development*, October 2015, p. 13, http://apps.unep.org/publications/index.php?option=com_pub&task=download&file=011830_en (12 October 2015).

The two main ways by which the private financial allocates money is through banking and investment. The latter covers all kinds of investors, investment instruments and financial markets, which are very intertwined and even linked with banking. Sustainability instruments can straddle different sub-segments of the banking or investors' world. This report is mainly divided according to initiatives in banking and investment sectors, but starts with a chapter with global and comprehensive initiatives covering all segments of the financial sector.

This report does not aim to offer an in-depth analysis of the many existing initiatives and strategies, nor to propose the mentioned initiatives and strategies as the (best) solutions. Given the many initiatives, the overview in this report could not be complete but made an effort to cover the main approaches and strategies. Too little information is disclosed about the actual impact, e.g. from voluntary initiatives, to allow for a thorough analysis and conclusions. The report briefly mentions a few existing criticisms or critical comments on the practice and assumptions that underpin some initiatives. In the concluding remarks, the report offers an outline for further analysis, assessment and discussion about the many existing initiatives, which could facilitate the identification of effective strategies to make the financial sector more aligned with social and environmental sustainability goals.

The report will hopefully be a source of information for civil society and others with an interest in addressing sustainability in the financial sector in the most effective way.

Although not all the mentioned initiatives are explained, references to the website of the initiatives are provided. In order to keep the footnotes as short, some references to the internet pages are embedded in the text as a hyperlink (see the grey words) and can be clicked on through the online version of this report on SOMO's website, downloadable at: <http://somo.nl/themes-en/financial>.

1 Goal: Integrating sustainability in the financial sector as a whole and at the global level

A range of initiatives that attempt to integrate social and environmental sustainability aspects in the financial sector are using an approach whereby the whole financial sector with its different segments is being covered. In contrast, quite some other initiatives target just one segment such as banking or investment, as explained in the next chapters of this report. Since the financial sector has become a global industry, initiatives to introduce sustainability in finance can be effectively initiated and promoted at international level. This chapter starts with global initiatives, covering all or particular segments of the financial sector, using international agreements or voluntary approaches.

1.1 The global politics of sustainability and finance

In the global political arena, sustainability has often been associated with the economics of developing economies, poverty reduction and environmental challenges, which are often addressed simultaneously. The finance policy area has mostly developed separately from social and environmental sustainability policies, despite increasing awareness of social corporate accountability. Especially after the financial crisis, globally agreed financial reforms have focused on achieving financial stability, ignoring the contribution finance should make to the global policy agenda of sustainability.

The concept of sustainable development was introduced to the political agenda by the Brundtland Commission in 1987.³ In 1992, the Rio Earth Summit resulted in 'Agenda 21' as a blueprint for socially and environmentally sustainable policies, which were to be financed among others through attracting private foreign direct investments.⁴ Since 2000, the financing of the social aspects of development has been a focus of the UN Millennium Development Goals (MDGs) (2000-2015) discussions since MDGs suffered from a lack of financial commitments at the two UN Financing for Development Conferences.

From 2016 onwards, the MDGs are to be replaced by the UN Sustainable Development Goals (SDGs, agreed in September 2015). The SDGs have to be implemented by developed and developing countries and require an estimated investment of US\$ 5-7 trillion a year.⁵ They only include a few commitments regarding the financial sector, such as expanding access to financial services for all (SDG 8.10) and improving the regulation, and its implementation, of global financial markets and

3 United Nations Report of the World Commission on Environment and Development: Our Common Future, 1987: sustainable development was defined as 'to meet the needs of the present without compromising the ability of future generations to meet their own needs'.

4 United Nations United Nations Conference on Environment & Development: Agenda 21, 1992.

5 UNEP Inquiry, *Ibidem*, p. xi-xiii.

institutions (SDG 10.5). The July 2015 Third UN Conference on Financing for Development⁶ included a commitment for 'pursuing sound macroeconomic policies that contribute to global stability, equitable and sustainable growth and sustainable development, while strengthening our financial systems and economic institutions' (paragraph 105). However, it refrained from calling for specific reforms of the financial system in order to finance or align with the SDGs.

In December 2015 at the meeting of COP21 (conference to the Parties of the UN Framework Convention on Climate Change (UNFCCC)), UN members are due to decide on an agreement to reduce CO₂ emissions and to adapt to climate change, for which billions of dollars of annual financing will be needed, according to different calculations. 'Climate finance' from public and private sectors, including financing transitions into renewable energy, as well as financing the needs of all dimensions of sustainable development is subject to discussions in many arenas, including at the G20.⁷

With specific regard to sustainable finance, the UN has produced several voluntary and non-committal initiatives to promote investments and other financing that at least do no environmental and social harm. The major initiatives started with the United Nations Environment Programme Finance Initiative (UNEP FI). Since 1992, this has been a platform for partnering between UNEP and the private financial sector, including banks, insurers and fund managers to promote discussion and better understanding, and to put forward different solutions, regarding the interlinkages between environmental and social aspects and financial performance.

The UN Global Compact was launched in 2000 as a worldwide voluntary corporate responsibility initiative to respect ESG aspects (see table 1) by all companies, including all kind of financial companies. Since 2006, the UN Principles for Responsible Investment (UN PRI) have promoted the incorporation of ESG aspects by institutional investors. The level of commitment is very different between the two initiatives (see Table 1). Analysis of the performance of the voluntary UN Global Compact⁸ and UN PRI, have clearly and publicly exposed how they are barely implemented⁹ and that '[h]aving a policy is necessary but not sufficient'.¹⁰ Worse still, some scholars¹¹ even argue that the UN Global Compact has caused the UN to be 'captured' by industry interests.

6 United Nations, Resolution adopted by the General Assembly on 27 July 2015 [on the] Addis Ababa Action Agenda of the Third International Conference on Financing for Development, 17 August 2015, http://www.un.org/ga/search/view_doc.asp?symbol=A/RES/69/313 (20 October 2015).

7 See for instance: UNEP Inquiry, *Ibidem*, p. 7-9; G20 Climate Finance Study Group, Report to the Finance Ministers, September 2014, <https://g20.org/wp-content/uploads/2014/12/18%20Climate%20Finance%20Study%20Group%20-%20Report%20to%20Ministers.pdf> (16 August 2015).

8 UN Global Compact Office, *United Nations Global Compact Office Annual Review 2010, 2011*, p. 3, 21, http://www.unglobalcompact.org/docs/news_events/8.1/UN_Global_Compact_Annual_Review_2010.pdf (10 June 2014): In their annual review of the Global Compact, focusing on the year 2010, the UN Global Compact Office state that businesses are found to struggle with implementing the principles into their day-to-day business activities. In fact, it is reported that '[t]he majority of companies are challenged to move from policy to action across all issues, as well as in subsidiary and supply chain practices'. The years 2011, 2012 and 2013 have not been reviewed.

9 UNEP Finance Initiative, *Fiduciary Responsibility: Legal and practical aspects of integrating environmental issues into institutional investment*, 2009, p. 10.

10 UN PRI, *Report on Progress*, 2011, p. 5.

11 See, for example: Thérien, J., Pouliot, V., Art. 'The Global Compact: Shifting the Politics of International Development', *Global Governance*, 2006, p. 12, 55 -75.

Table 1: Comparing UN Global Compact and UN PRI voluntary guidelines

UN Global Compact (2000)	UN PRI (2006)
<p>On human rights:</p> <ol style="list-style-type: none"> 1 Businesses should support and respect the protection of internationally proclaimed human rights; and 2 make sure that they are not complicit in human rights abuses. <hr/> <p>On labour:</p> <ol style="list-style-type: none"> 3 Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining; 4 eliminate all forms of forced and compulsory labour; 5 strive for the effective abolition of child labour; and 6 eliminate discrimination in respect of employment and occupation. <hr/> <p>On the environment:</p> <ol style="list-style-type: none"> 7 Businesses should support a precautionary approach to environmental challenges; 8 undertake initiatives to promote greater environmental responsibility; 9 encourage the development and diffusion of environmentally friendly technologies. <hr/> <p>On anti-corruption:</p> <ol style="list-style-type: none"> 10 Businesses should work against corruption in all its forms, including extortion and bribery. 	<ol style="list-style-type: none"> 1 We will incorporate ESG issues into investment analysis and decision-making processes; 2 We will be active owners and incorporate ESG issues into our ownership policies and practices; 3 We will seek appropriate disclosure on ESG issues by the entities in which we invest 4 We will promote acceptance and implementation of the Principles within the investment industry; 5 We will work together to enhance our effectiveness in implementing the Principles; 6 We will each report on our activities and progress towards implementing the Principles.

Source: Spruijt, C., *A review of existing strategies to promote sustainability goals in the financial sector, draft paper, July 2014: own compilation.*

Regarding the financing of particular sectors, integrating environmental and social concerns in their financing or investing instruments has for instance been done for the agricultural sector.¹² In 2010, the World Bank, the Food and Agriculture Organization (FAO) and the United Nations Conference on Trade and Development (UNCTAD) launched the Principles for Responsible Agricultural Investment (PRAI). These are to be applied for public, private, foreign and domestic investments including from private equity firms, financial institutions and sovereign wealth funds. In 2011, a number of investment funds associated with the UN PRI unveiled the Principles for Responsible Investment in Farmland¹³ which were incorporated in the UN PRI in 2014 as the 'Farmland Principles'. The FAO promoted the adoption in 2012 of the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security by the Committee

12 For a comprehensive overview and analysis of these sector initiatives, see: Clapp, J., Art. 'Responsibility to the Rescue? Governing Private Financial Investment in Global Agriculture', *Agriculture and Human Values*, [forthcoming].

13 Clapp, J., *Ibidem*.

on World Food Security (CFS). In 2014, the CFS adopted the Principles for Responsible Investment in Agriculture and Food Systems (PRIAFS).

The focus on financing social sustainability aspects, and especially poverty mitigation, is the subject of the different initiatives, so far without any binding commitments, to promote “inclusive finance” and access to finance by the poor and small farmers or companies.¹⁴ After the UN launched the International Year of Microcredit in 2005 as part of achieving the MDGs, UN initiatives included the UN blue book Building Inclusive Financial Sectors for Development (2006) and the UN Secretary General Special Advocate for Inclusive Finance for Development, to highlight the importance of financial inclusion in the context of the UN Financing for Development initiatives. The Principles for Investors in Inclusive Finance were launched in 2014 as part of UN Principles for Responsible Investment (PRI). Other global initiatives include the World Bank’s Global Findex and Financial Inclusion Support Framework (FISF), and the Financial Access Survey (FAS) of the International Monetary Fund (IMF). The G20 Global Partnership for Financial Inclusion (GPFI) is implemented by the Consultative Group to Assist the Poor (CGAP) – a global partnership of 34 leading organisations, the Alliance for Financial Inclusion (AFI) – a network of 117 central banks and regulators covering more than 90 developing countries, the International Finance Corporation (IFC) and the World Bank.

More broadly, social aspects such as human rights have been promoted by the adoption in 2011 of the UN Guiding Principles on Business and Human Rights, which target states and all companies, including financial companies. However, BankTrack has reported how major international banks have weak implementation of those principles. The International Labour Organisation (ILO) is organising initiatives regarding labour rights for those working in the financial sector.¹⁵ This field of work relates to one aspect that banks often mention in their sustainability reports, namely the treatment of their workers.

In parallel, the G20 Ministers of Finance and Governors of Central Banks have been agreeing on international standards for reforms in banking, insurance, investment and financial (derivatives) markets since the 2008 financial crisis. Their decisions were endorsed by the G20 Leaders Summits and the execution (by international financial standard bodies) was coordinated and reviewed by the Financial Stability Board (FSB). Sustainability issues were hardly considered in relation to financial reforms except for the G20 Global Partnership for Financial Inclusion (GPFI: see above), and the G20 Climate Finance Study Group (CFSG).¹⁶ The latter had the aim of sharing national experiences between G20 countries and mobilising finance to address climate change in addition to efforts in the context of the UNFCCC.

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- 14 For an analysis about inclusive finance initiatives and regulations, see: Magaldi de Sousa, M., Financial Inclusion and Global Regulatory Standards – An Empirical Study across Developing Economies, Paper No. 7, New Thinking and the New G20 Series, March 2015; and Hawkins, P., Lessons from Inclusive Banking Experiments in South Africa and Kenya, UNEP Inquiry Working Paper, Aug 2015, <http://unepinquiry.org/publication/inclusive-banking-sa-kenya/> (15 October 2015).
- 15 BankTrack, Banking with principles? Benchmarking banks against the UN Guiding Principles on Business and Human rights, December 2014, http://www.banktrack.org/manage/ems_files/download/bankingwithprinciples_humanrights_dec2014_pdf/hr_banking_with_principles_digital_0.pdf (27 October 2015).
- 16 See the 2015 report: G20 Climate Finance Study Group, Report to the Finance Ministers, September 2015 <https://g20.org/wp-content/uploads/2015/09/G20-Climate-Finance-Study-Group-Annual-Report.pdf> (10 September 2015).

In April 2015, the G20 Ministers of Finance asked the FSB to consider the implications and risks to the financial sector from climate change, including whether information in the financial markets about the impact of climate change is adequate and the preparedness of the financial sector is good enough to understand the long-term risks.¹⁷ The FSB is considering a voluntary industry-led disclosure taskforce for clear and efficient transparency that enables the financial industry to assess the risks from climate events or the transition to a low-carbon economy.¹⁸

It needs to be noted that none of the above international financial agreements and initiatives regarding sustainability and finance are legally binding. In general for the financial sector, no international treaty currently exists to make any financial regulation agreement internationally binding, except for legally binding commitments to liberalise and protect financial sub-sectors in trade and investment treaties. International financial standards, such as the ones agreed upon by the Basel Committee on Banking Supervision and adopted by the G20, only become binding through national and EU legislation. Non-legally binding and voluntary initiatives face many challenges of implementation and their impact is often assessed to be minimal and slow.¹⁹ There is insufficient information available to analyse and assess the implementation of the above-mentioned initiatives.

1.2 A comprehensive and global approach to integrating sustainability in finance

During 2014-2015, the UNEP Inquiry into the Design of a Sustainable Financial System – an independent UNEP project – has been exploring how, and through which policy options, to make sure that the financial sector supports sustainable development and the transition to an inclusive, and especially green low-carbon economy.²⁰ The Inquiry looked across the main segments of the financial system, such as banking, bond and equity markets, institutional investment, insurance, and monetary policy. It focused on the environmental dimension of sustainable development and had a working hypothesis that, if the financial sector continues to develop in a business-as-usual scenario, negative environmental outcomes will increase rapidly and such externalities might reduce higher levels of development at national levels and globally.²¹

17 Financial Stability Board, [Chair's Letter] To G20 Finance Ministers and Central Bank Governors, Financial Reforms – Progress on the Work Plan for the Antalya Summit, 5 October 2015, <http://www.financialstabilityboard.org/wp-content/uploads/FSB-Chairs-letter-to-G20-Mins-and-Govs-5-October-2015.pdf> (18 October 2015): The FSB identified so far three types of financial stability risks: physical risks (direct impacts on property or trade disruption), liability risks (which could arise if parties that have suffered damage seek compensation in the future from those they hold responsible) and transition risks (financial risks arising from the transition to a lower carbon economy); see also the speech by the FSB Chair to UK insurance sector: M. Carney, Breaking the tragedy of the horizon – climate change and financial stability, Speech, 29 September 2015, <http://www.bankofengland.co.uk/publications/Pages/speeches/2015/844.aspx> (15 October 2015).

18 Financial Stability Board, [Chair's Letter], Ibidem.

19 See for instance: UNEP Inquiry, Ibidem, p. xiv-xv, p. 35.

20 All information can be downloaded from www.unep.org/inquiry as well as <http://web.unep.org/inquiry>.

21 UNEP Inquiry, Ibidem, p. xiii and fig. 1.

The UNEP Inquiry project worked with central banks, environment ministries, international financial institutions, major banks, stock exchanges, pension funds and insurance companies. During 2014 and 2015, several UNEP Inquiry reports were released. Since the project looked in detail at practice in more than 15 countries, some of these reports focused on particular countries, including China, Indonesia, Brazil and Bangladesh. They were developed with financial authorities and included concrete recommendations for policies to make the financial sector greener, such as in banking, funds, loans, financial markets, stock exchanges, ratings and carbon trading (many are being listed under the different initiatives in this report).²²

The UNEP Inquiry's main global report was released on 8 October 2015 together with more than 50 working papers²³ looking at different segments, countries and approaches. They are the basis for spreading the information and proposals at a national level, e.g. through country-level meetings, and for promoting international collaboration by financial authorities, e.g. at the G20.

The UNEP Inquiry reports on a 'quiet revolution'²⁴ and 'emerging practice in embedding sustainable development into the financial system' according to five different aspects of the financial sector which UNEP Inquiry assesses to have various effects, as follows²⁵:

1. **Improvements by the financial sector:** is widely adopted in voluntary measures and practices but has slow modest impacts.
2. **Upgrading the governance of the financial sector** through financial regulation and by central banks: least practised but is critical to support all sustainability practices.
3. **Using policy to direct finance:** policy-makers start to adopt sustainability in their financial policies, which can be successful.
4. **Harnessing the public balance sheet to influence financial flows:** is widely adopted but has a limited impact due to its costs.
5. **Transforming the behaviour and culture in the financial sector:** not widely practised but can be effective.

The UNEP Inquiry project makes clear that in practice, policy-makers, regulators and central banks in developing and emerging economy countries are more advanced in taking measures to integrate sustainability into finance than those from developed countries. National and international initiatives and practices are mostly voluntary measures by different segments of the financial industry. At the level of international standard-setting bodies, the request by the G20 to the Financial Stability Board to address how the financial sector can take account of climate-related issues might be the start of more international cooperation to integrate sustainability in financial reforms.

22 To download the reports, see: <http://web.unep.org/inquiry>.

23 See: <http://unepinquiry.org/?s=> .

24 UNEP Inquiry, *Ibidem*, chapter 3.

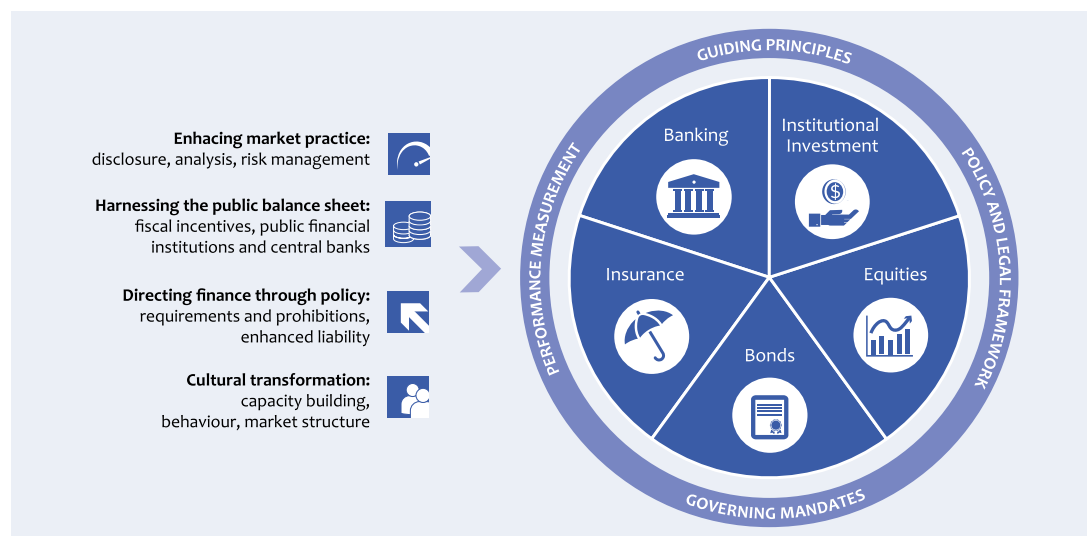
25 UNEP Inquiry, *Ibidem*, p. xiv-xv, p. 35.

The UNEP Inquiry project acknowledges that early stage innovations that advance sustainable finance have not become common practice. Financialisation²⁶ of the economy continues, and finance remains disconnected from sustainable development for three core reasons:²⁷

1. Environmental and social costs are not fully accounted for in the real economy.
2. Too few fiscal resources.
3. Financial system rules do not ensure financial decision-making that takes account of social and environmental risks and opportunities.

UNEP Inquiry sees a historic opportunity to develop a sustainable financial system. In order to align the financial system with sustainable development, the UNEP Inquiry advocates a systematic approach beyond ad hoc innovations and business-as-usual financial market development. It proposes a framework for action with ‘practical pathways drawing on a toolbox of measures based on country experiences’ (see Figure 1), which is developed further in its final report and the different accompanying reports.²⁸ Action is needed at national, regional and international level by the many diverse actors from those in the financial sector and in the sustainable development community to individuals such as customers and employees, best done through coalitions.

Figure 1: What can be done: Toolbox from practice to options for policy according to UNEP Inquiry



Source: UNEP Inquiry, *The financial system we need – Aligning the financial system with sustainable development*, October 2015, p. xvi.

26 UNEP Inquiry defines ‘financialisation’ as ‘where financial returns increasingly arise from transactions that are disconnected from long-term value creation in the real economy’.

27 UNEP Inquiry, *Ibidem*, p. 2.

28 See: UNEP Inquiry, *Ibidem*, p. xviii, chapter 4 and chapter 5.

UNEP Inquiry indicates that there is a deficit in knowledge and capacity by civil society organisations (CSOs) when it comes to the financial sector, and by financial experts or actors regarding sustainable and environmental sustainability.²⁹ Overall, UNEP Inquiry warns that the measures identified in its reports 'are unlikely to protect society from other financial system weaknesses that enable mispricing, rent-taking and instability' and from ongoing short-termism in an over-complex and over-sized financial system. However, UNEP Inquiry hopes that 'the cumulative impacts of such [identified] measures can be more than the sum of their parts. Implemented with ambition and engagement, they can trigger broader, system-level shifts' and a 'renewed sense of purpose'.³⁰

The UNEP Inquiry project with its multi-stakeholder activities at the international and national level, its experiments with various methodologies and analyses, and the many related publications, has been an interesting approach that catalysed many actors in the financial sector who would otherwise not be reached. Its message that the most practiced approach, namely voluntary measures by the financial sector, might be little effective compared to the intervention and regulation by authorities, which is much less practiced especially in developed countries, will hopefully not be lost. The inquiry project could be repeated regarding the integration of the social aspects of sustainable development into finance. However, the project leaves the question open whether greening and inserting environmental sustainability aspects in a financial system that is fundamentally mal-functioning will be effective in the long term (see concluding remarks).

1.3 A comprehensive approach to cover the whole financial sector through national policy development

In a few countries, attempts are being made to develop a comprehensive national plan with measures that should apply to all the different segments of the financial sector.³¹

Examples: Indonesia (Roadmap for Sustainable Finance), China (Green Finance Committee), France (White Paper on Financing the Ecological Transition), Switzerland (Swiss Sustainable Finance Initiative)

In Indonesia,³² the financial services regulator – the Otoritas Jasa Keuangan (OJK) – developed a 10-year Roadmap for Sustainable Finance in 2014 to spell out the different measures that should increase sustainable finance. The Roadmap was developed in dialogue with the financial industry and has created a newly established multi-stakeholder taskforce. The Roadmap applies to banking, capital markets and non-bank financial services sectors.

29 UNEP Inquiry, *Ibidem*, p. xx.

30 UNEP Inquiry, *Ibidem*, p. xvii, xxi.

31 Particular measures that change bank or investors behaviour mentioned in this chapter as part of an comprehensive approach, are covered in more detail in the next chapter.

32 See amongst others: UNEP Inquiry, *Ibidem*, p. 23-24, 31, 33; See the report by UNEP Inquiry in partnership with the IFC and the Association for Sustainable and Responsible Investment in Asia: *Towards a Sustainable Financial System in Indonesia*, April 2015, http://apps.unep.org/publications/index.php?option=com_pub&task=download&file=011741_en (10 May 2015).

It includes measures such as:

- ▣ regulatory support and incentives, targeted loans and guarantee schemes, green lending models, green bonds and a green index;
- ▣ raising awareness among market players about environmental risks, risk management and mitigation practices, including education of supervisors and practitioners;
- ▣ requirements to adopt social and environmental risk management policies and associated public disclosure.

China's central bank – the People's Bank of China – co-convened in 2014 with UNEP Inquiry, a Green Finance Task Force that involved many officials and market actors. The initiative aimed to draw up proposals for a green financial system and resulted in 14 recommendations across the different segments of the financial sector, from banking to investment instruments, according to 'four broad themes: information flows, legal frameworks, fiscal incentives and institutional design'.³³ The follow-up of the proposals is taken up by a newly established Green Finance Committee, amongst others, to make environmental disclosure mandatory under China's securities law, and develop government-sponsored green bond guidelines. When drafting the 13th Five-Year Plan for the reform and development of China's financial sector, green finance will be a key element.³⁴

In November 2013, France launched a White Paper on Financing the Ecological Transition, a joint initiative of the Ministry of Ecology and the Treasury.³⁵ The follow-up to the White Paper, stimulated by France's chairmanship and hosting of the COP 21 climate change conference at the end of 2015 in Paris, resulted in the French Energy Transition law in May 2015. The law makes reporting mandatory for investors how they manage climate change and other sustainability factors, including how they contribute to limiting climate change.

In Switzerland, the Federal Office for the Environment launched the Swiss Sustainable Finance Initiative³⁶ to consult about a Swiss perspective on sustainability in finance and to explore it as a competitive advantage after huge changes in the Swiss regulatory regime and financial markets following the financial crisis.

33 China Green Finance Taskforce, Establishing China's Green Financial System, UNEP Inquiry/People's Bank of China, 2015; See the UNEP Inquiry reports regarding the different segments of the Chinese financial sector at: <http://web.unep.org/inquiry>.

34 UNEP Inquiry, The Financial System We Need, p. 35: according to Pan Gongsheng, Deputy Governor, People's Bank of China.

35 See, among others: UNEP Inquiry, Ibidem, p. 27.

36 See, among others: <http://www.sustainablefinance.ch/>; Design of a Sustainable Financial System: Swiss Team Input into the UNEP Inquiry, 2015, http://apps.unep.org/publications/index.php?option=com_pub&task=download&file=011740_en (15 October 2015).

1.4 Advocacy and campaigning covering the whole financial sector as a strategy by civil society organisations

Examples: FinanceWatch, Friends of the Earth, SOMO, FairFin, UK Transforming Finance Network, Financial Stability Board Watch, , Financial System Resilience Index

Although many citizens have had to bear the brunt of the financial crisis and the scandalous practices of the financial sector, compared to other areas such environmental issues, CSOs and citizens are not very involved in influencing the financial sector and financial policies or regulation. Social movements and CSOs have been engaging in advocacy for voluntary measures and more transparency by the financial industry itself (see next chapters). However, a few have also encouraged governments and financial authorities to impose mandatory regulations and measures on the different segments of the financial sector. Their campaigns aim to put issues on the political agenda by informing about the social, environmental and economic consequences of financial sector developments and by influencing public opinion and raising political debates.

At an international level, the US-based Financial Stability Board Watch (FSB Watch)³⁷ and related NGOs have been monitoring and engaging with the FSB to press for stricter standards for the various financial sector segments either developed or coordinated by the FSB, and to ensure that the voices of developing countries and civil society are being heard. Together with other NGOs, FSB Watch has signed on in June 2015 to a letter to the G20 critically commenting on the current state of financial reforms, including its failure to include ESG criteria.³⁸

FinanceWatch³⁹ is a Brussels-based NGO with members all over the EU. It has a strategy to be an alternative source of information for policy-makers during the decision-making process of many financial sector regulations on the agenda of the European Commission, the European Parliament and the EU Council of Finance Ministers. Its lobby activities function as a counterweight to private sector lobbyists. In addition, FinanceWatch develops and encourages the debate to press for binding regulation⁴⁰ and looks at how financial sector regulations should be at the service of the public interest. With this in mind, FinanceWatch is developing a 'dashboard' on what constitutes financing that puts public and societal interests at heart. Through its *Change Finance! campaign*, FinanceWatch it has tried to reach citizens to support the call for stricter regulation with the slogan 'Finance rules the world. Let's change the rules!'. One of FinanceWatch members, SOMO⁴¹, already argued in 2011 that the EU's new financial regulations were ignoring sustainability aspects.⁴²

37 <http://fsbwatch.org/> (20 October 2015).

38 Preventing the next financial and debt crisis – G20 must address systemic risks in financial markets, continue the financial reform process, and find solution for sovereign debt crisis, declaration signed by 14 NGOs, 12 June 2015, http://www.somo.nl/news-en/financial-reforms-in-focus/at_download/attachment (15 July 2015).

39 <http://www.finance-watch.org/> (20 October 2015).

40 See for materials: <http://www.finance-watch.org/hot-topics/campaign-change-finance> .

41 <http://somo.nl/themes-en/financial> (20 October 2015).

42 See, for instance, Vander Stichele, M., The Missing Dimension - How European Financial Reforms Ignore Developing Countries and Sustainability, November 2011, http://somo.nl/publications-en/Publication_3712/at_download/fullfile (June 2015).

At national level, for instance, FairFin⁴³ has a creative campaign in Belgium to challenge the lack of democracy and civil society voices in the regulatory process of the financial sector. In the UK, the informal UK Transforming Finance Network⁴⁴ intends to change the financial system into one that serves society, the environment and the wider economy. In May 2013, some of the network members published a Charter for a New Financial System, which is supported by 40 organisations worldwide. To influence the 2015 UK elections, the network sets out five priorities for change, namely diversity, transparency, responsibility, sustainability and democracy.

The New Economics Foundation created the Financial System Resilience Index⁴⁵, which identifies seven major factors that can be measured and should be addressed to avoid another crisis by the financial sector: diversity, interconnectedness, financial system size, asset composition, liability composition, complexity and transparency, and leverage. The index is used to compare the resilience of the financial sectors in different countries.

The lobbying by the financial industry is so well-resourced and powerful, that it has proven difficult for those NGOs and social movements that criticise, comment or propose alternatives to regulatory proposals, to raise their voice and to have their position heard or taken into account in the financial regulatory decision-making process. Some CSOs such as Corporate Europe Observatory (CEO) and CSO networks like Alter-EU have exposed the lobbying practices of the financial sector, which influences EU policy-makers and regulators to take decisions that harm the public interest and are against social and environmental sustainable policies, laws and standards.⁴⁶ Note that the dominance of the financial sector lobby has resulted in most EU legislators and supervisors not having heard or understood the call for integrating social and environmental sustainability into EU legislation and policies.

43 www.fairfin.be/en/ (20 October 2015).

44 <http://transformingfinance.org.uk/> (20 October 2015).

45 <http://www.neweconomics.org/publications/entry/financial-system-resilience-index> (20 October 2015).

46 See for instance: Wolf, M., Haar, K., and Hoedeman, O., The fire power of the financial lobby - A survey of the size of the financial lobby at the EU level, published by CEO, Arbeiterkammer and ÖGB, April 2014, <http://corporateeurope.org/financial-lobby/2014/04/fire-power-financial-lobby> (20 October 2015); See also: <http://corporateeurope.org/economy-finances/financial-lobby>; For exposure of financial lobbying at the national level see for instance: Römgens, I., Van Tilburg, R., Taking lobbying public – The transparency of Dutch banks' lobbying Activities, SOMO, December 2013, http://www.somo.nl/publications-en/Publication_4016/at_download/fullfile (15 June 2015).

2 Goal: Changing bank behaviour

This chapter focuses on mapping the approaches and strategies used to integrate social and environmental sustainability aspects into the private banking sector. Banking plays a very important role in most societies. The specific policies and practices that banks draw on to include sustainability in their lending criteria and services are assumed to have far-reaching effects through banks' multiplier effect that can impact on the whole economy.

2.1 Mandatory regulations as an approach to make banking in line with sustainable development

Legally binding and enforceable laws, regulations, standards and other requirements have a direct impact on how banks provide lending and financial services and on banks' business models to make profits.

2.1.1 Mandatory requirements on bank lending and risk assessments

Examples: China (Green Credit Guidelines), Brazil (Circular 3547 on ICAAP and Resolution No. 4,327), Bangladesh, Peru (Resolution 1928–2015 of the SBS)

Requiring banks to take into account their exposure to risks resulting from social or environmental damage can introduce mandatory requirements up to legal prohibitions in order to shift credit and capital allocation. Forcing banks to take social and environmental risks into account at least stands a chance of making sustainability-related concerns internal to their day-to-day operations and makes it more difficult to circumvent.

A 2014 study by the UNEP Inquiry⁴⁷ and a study jointly published by the UNEP Finance Initiative and the Cambridge University Institute for Sustainability Leadership⁴⁸ both provide a good overview of existing measures aiming at sustainable outcomes, both voluntary and mandatory, specific or not, by which the financial sector operators are covered. Table 2 provides a very brief synopsis of how existing mandatory regulation applies to mainly to banks.

An important international standard for banking reforms after the financial crisis has been the Basel III requirements by the Basel Committee on Banking Supervision and its legal embedding in national

47 UNEP Inquiry, *Aligning the Financial System with Sustainable Development: Insights from Practice*, October 2014, http://apps.unep.org/publications/index.php?option=com_pub&task=download&file=011743_en (4 December 2014).

48 Alexander, K., *Stability and Sustainability in Banking Reform: Are environmental risks missing in Basel III?*, University of Cambridge Institute for Sustainability Leadership, August 2014, <http://www.unepfi.org/fileadmin/documents/StabilitySustainability.pdf> (10 October 2014).

and EU laws. An analysis has highlighted the potential for integrating environmental risks into Basel III requirements for reviews by supervisors ('Pillar 2'), for example through (environmental) stress testing, and for market discipline ('Pillar 3'), for example through enhanced transparency.⁴⁹ This was applied by several countries, such as Brazil. In 2011, the Brazilian central bank – Banco Central do Brasil (BACEN) – was the world's first banking regulator to request that banks monitor environmental risks as part of the implementation of Basel III's internal review for capital adequacy. Based on the voluntary Green Protocol that was developed by the Brazilian banking sector and dialogues with the sector, BACEN introduced requirements in 2014 that environmental and social risk management systems have to be in place for all banks, with principles of relevance and proportionality.⁵⁰

In China in 2012,⁵¹ the China Banking Regulatory Commission (CBRC) issued the *Green Credit Guidelines* to encourage banks to promote green credit as a strategy to support China's transition from a largely coal-based and resource-intensive economy to a more sustainable model for economic development. The Guidelines require banks to monitor their borrowers' compliance with environmental regulation and demand early loan repayments and/or suspend lending if a borrower is seen to be failing. The Guidelines are evolving to a standardised, metrics-driven performance assessment of all licensed banks and in future a stronger legal and judicial basis for environmental lender liability is likely.

In Bangladesh,⁵² the central bank has priority lending requirements for rural enterprises and for green finance. By 2015, all banks in Bangladesh have to allocate 5% of loans to green projects, including renewables, energy efficiency and waste management. The central bank allows banks to consider such green sector loans in their risk management as high-quality assets.

Peru introduced new regulations in March 2015 and requires banks to incorporate environmental and social factors into due diligence, effective from March 2016.

Mandatory regulations, standards and measures have been resisted in many other countries by the financial industry. The strategy to integrate sustainability in banking through laws and other legally binding regulations and standards has also challenges, such as unintended consequences.⁵³ Another potential drawback of this strategy is that it most likely will focus on the material impact of ESG factors, e.g. visible environmental destruction, while the ethical case, e.g. conserving bio-diversity for future generations, is hardly made.

49 Alexander, K., *Ibidem*.

50 UNEP Inquiry, *The Financial System We Need*, p. 19, 20.

51 See for instance, UNEP Inquiry, *Ibidem*, p. 30.

52 See for instance, UNEP Inquiry, *Ibidem*, p. 27.

53 See for instance: Sandberg, J., *Towards a Theory of Sustainable Finance*, UNEP Inquiry Working Paper 15/08, October 2015, http://apps.unep.org/publications/index.php?option=com_pub&task=download&file=011823_en (10 October 2015).

Table 2: Mandatory regulations affecting mostly banking, by 2014

Country	Name of framework	Scope	Targeted constituency	
Bangladesh	Environmental Risk Management Guidelines for Banks and Financial Institutions in Bangladesh	Environmental and Social Risk Management	Banks and Financial Organisations under the Financial Institutions Act (former Non-Bank FIs)	The Bangladesh Central Bank has also put in place, or is in the process of putting in place, measures to direct more commercial bank loans to 'priority areas', such as agriculture or renewable energy. This takes the form of concessional refinancing at lower interest rates for such loans, or direct requirements to allocate a share of the loan portfolio to those sectors. There are also banking licence requirements to expand provision of basic financial/payment services to rural areas and poorer people.
Brazil	Resolution 3545 on the Amazon Biome (2008)	Conditions for granting rural credit	Regulated financial institutions, financial institutions integrated in the National Rural Credit System (SNCR)	
	Resolution 3813 on Sugar Cane (2009)	Financing biofuel production		
	Resolution 3876 on Slave Labour (2010)	Prohibiting slave labour		
	Circular 3547 on ICAAP (Internal Capital Adequacy and Assessment Process under Basel III) (2011)	Risk assessment and capital sufficiency		Requires banks to demonstrate how they take exposure to social and environmental damage into account.
	Resolution No. 4,327 (2014)	Social and Environmental Responsibility Policy (PRSA) guidelines (governance structure and management of environmental risks)		Financial institutions and other entities authorised by the Central Bank of Brazil
China	Green Credit Policy (GCP)		Policy banks, state-owned commercial banks, joint-stock commercial banks, financial assets management companies, Postal Savings Bank of China, provincial rural credit unions, all trust firms, enterprise group finance companies and financial leasing firms directly regulated by the China Banking Regulatory Commission	
	Green Credit Guideline (GCG)	Environmental & social risk management, internal management and management structure, information disclosure		
EU	Directive on annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings (2003; mandatory for EU states to transpose in national legislation)	Reporting: states that it should not be restricted to the financial aspects of the company's business, but, where appropriate, include analysis of environmental and social aspects	Most credit institutions and other financial institutions	
EU	Directive regarding the disclosure of non-financial and diversity information by certain businesses (Directive 2014/95/EU)	Disclosure of non-financial and diversity information to the shareholders and other investors	Certain large businesses, including banks and insurance companies, with over 500 employees	The information to be disclosed includes policies, risks and outcomes as regards environmental matters, social and employee-related aspects, respect for human rights, anti-corruption and bribery issues, diversity in the board
Nigeria	Nigerian Sustainable banking Principles and Guidance Note, incl. 3 Sector-Specific Guidelines	Environmental and social risk management	Banks, discount houses and development finance institutions	Quasi-mandatory regulation
Peru	Resolution 1928 – 2015 of the SBS, March 2015	Environmental and social risk management	All Peruvian banks	
Viet Nam	Environmental and Social Risk Management Circular	Environmental and social risk management	All Vietnamese banks	

2.1.2 Mandatory requirements for 'inclusive finance'

Examples: India, Bangladesh, the United States

An important aspect of social sustainability is to reduce poverty. Banks can contribute to this by operating in an inclusive way, meaning that they provide services to the poorest populations and sectors, such as in rural areas or poor city areas and to the smallest companies, with affordable universal access to basic financial services that do not create debt. In monetary economies, having access to cash and non-cash payment systems, and saving accounts is important. Private banks have tended to focus on the most profitable clients and services, contrary for instance to postal or other state-owned banks. This means that large sections of the population in developing countries are still deprived of basic financial services that would promote their economic development.

In different countries, "priority sector lending" – e.g. for small- and medium-sized enterprises (SMEs), agriculture or small farmers – has been used to make sure that deprived and critical sectors of society and the economy have access to credit. In Asia, different priority sector lending programmes are in place, with a record of both well-run programmes and failures.⁵⁴

Mandatory measures have been introduced by Bangladesh Central Bank (see Table 2) through licensing requirements that force commercial banks to open a rural branch for every new branch in an urban area, and to offer bank accounts to poor people in the form of accounts that can be opened with a deposit of 10 Taka (less than a fifth of one US\$).⁵⁵ In addition, the Bangladesh Central Bank offered low-cost refinancing to commercial banks' lending to the rural economy.

In India, priority sector lending has been in place for many decades. Measures include licensing policies that obliged banks, although not foreign banks⁵⁶, to open branches in rural or unbanked areas and to lend in those areas or to particularly underfinanced sectors such as SMEs and agriculture. In August 2014, a new financial inclusion programme was launched, starting with providing universal access to banking facilities through opening nearly 40 million accounts.⁵⁷ This mandatory inclusive finance programme has its pitfalls, as it also resulted in too high indebtedness by the poor.⁵⁸

54 Creehan, S., Priority Sector Lending in Asia, Federal Reserve Bank Of San Francisco - Country Analysis Unit, September 2014, <http://www.frbsf.org/banking/publications/asia-focus/2014/september/priority-sector-lending-in-asia/Asia-Focus-Priority-Sector-Lending-in-Asia-September-2014.pdf> (20 October 2015).

55 UNEP Inquiry, Aligning the Financial System with Sustainable Development: Insights from Practice, October 2014, p. 13; UNEP Inquiry, The Financial System We Need, p. 19.

56 Singh, K, Vander Stichele, M., Rethinking Liberalisation of Banking Services under the India-EU Free Trade Agreement, SOMO, September 2009, http://www.somo.nl/publications-en/Publication_3220/at_download/fullfile (15 June 2015).

57 Singh, K., Jan Dhan Yojana: Ambitious but Ambiguous Plan, Madhyam Commentary, 23 September 2014, Singh, K., Jan Dhan Yojana: Ambitious but ambiguous plan, Commentary, Madhyam, 23 September 2014. Singh, K., Jan Dhan Yojana: Ambitious but ambiguous plan, Commentary, Madhyam, 23 September 2014. <http://www.madhyam.org.in/jan-dhan-yojana-ambitious-but-ambiguous-plan/> (20 September 2015).

58 Singh, K., The trials of banking the unbanked in India, Financial Times, 17 September 2015, <http://blogs.ft.com/beyond-brics/2014/09/17/guest-post-the-trials-of-banking-the-unbanked-in-india/> (20 September 2015).

In 2015, India's central bank added loans to sanitation, drinking water facilities and renewable energy under the priority sector obligations.⁵⁹

A widely referenced example of a mandatory inclusive finance programme in the developed world is the Community Reinvestment Act (CRA) in the US, which started in 1977. The CRA aims to ensure that banks lend to communities that are in poor neighbourhoods or dominated by ethnic minorities where banks operate but have in principle a strategy to limit their services and not to lend in that area ('redlining').

2.1.3 Legal obligations to report social and environmental impacts

Example: EU Directive regarding the disclosure of non-financial and diversity information by certain businesses (Directive 2014/95/EU)

In October 2014, an EU law was adopted that required large financial companies with over 500 employees, such as banks and insurance companies, alongside certain other companies, to disclose non-financial information (see table 3). Banks are so required from 2017 onwards to annually provide information on 'policies, risks and outcomes as regards environmental matters, social and employee-related aspects, respect for human rights, anti-corruption and bribery issues, and diversity in their board of directors'.⁶⁰ The Directive does, however, leave significant flexibility regarding this mandatory reporting by allowing a 'comply or explain' approach and not providing minimum, common indicators.

2.1.4 Strategies by CSOs advocating for mandatory sustainability regulation for banks

Examples: FinanceWatch, BankTrack, Friends of the Earth, SOMO, FairFin

CSOs such as the Brussels-based FinanceWatch (see 1.4) and its members have been proposing and advocating for improvements in bank regulation at the EU level to protect the public interest and avoid financial crises that have huge economic and social consequences such as unemployment that followed the 2008 financial crisis in the EU. Examples have been advocacy and lobby activities, based on research, on the Capital Market Directive IV and the Regulation on bank restructuring so as to separate basic banking activities from the speculative activities (e.g. trading in derivatives). CSOs have also been active to change future bank laws at national level in the EU, for instance in France.⁶¹

59 UNEP Inquiry, *The Financial System We Need*, p. 24.

60 European Commission, *Non-Financial Reporting*, [Website information, October 2014], http://ec.europa.eu/finance/company-reporting/non-financial_reporting/index_en.htm (16 October 2015).

61 See the different dossiers on the website of Finance Watch: <http://www.finance-watch.org/our-work/dossiers> and <http://www.finance-watch.org/our-work/dossier-archive> (15 October 2015).

One example of NGO advocacy for better bank regulation is the work in 2011 by SOMO and Profundo for BankTrack and Friends of the Earth Europe. In response to a public consultation by the Basel Committee on Banking Supervision and the European Commission to prepare a new law on banks (Basel III), they argued that sustainability criteria should be integrated in the risk assessment system as well as the capital requirements by banks (Pillar 1 of Basel III).⁶² The general proposal was that banks that induce greater amounts of negative social and environmental impact are forced to hold higher capital reserves – providing them with an incentive to act in a more socially and environmentally responsible way. For instance, banks ‘should differentiate risk weighting factors for various categories of borrowers according to their level of sustainability, each with a different probability of default’.⁶³ The initiative partly relies on the assumption that sustainable borrowers have a lower probability of default than non-sustainable borrowers. However, the NGOs’ efforts were unsuccessful and their proposals did not make the final version of Basel III and the related EU Capital Requirements Directive IV.

2.2 Incentives from governments to direct bank behaviour

Example: South Africa’s Financial Services Code

In order to change bank behaviour, governments can also provide incentives such as financial benefits and prospective financial profits.

One example is South Africa’s Financial Services Code⁶⁴ which resulted from a voluntary multi-stakeholder Financial Services Charter and is as part of the Black Economic Empowerment policies. The Financial Sector Code intends to provide the historically disadvantaged majority of the country better access to financial services and credit, and better employment opportunities in the financial sector. The government provides incentives by requiring compliance with the charter by those bidding for public procurement contracts for financial services, and in addition, by providing successful bidders with concessional refinancing and variations in capital requirements to offset additional risk.

2.3 Developing policies by sharing information

Examples: Sustainable Banking Network, China’s Green Finance Task Force, France Stratégie

Networks and discussion platforms are organised or supported by authorities for sharing information and identifying proposals and best practices in order to increase understanding and knowledge to

62 SOMO et al., Sustainability criteria in banking rules: How to integrate sustainability in capital requirements, March 2011, http://somo.nl/publications-nl/Publication_3649-nl/at_download/fullfile (15 June 2015).

63 FoEE et al., Submission to the Basel Committee, March 2011, p. 4.

64 For more information about the different aspects of the code and the Charter, see: http://www.fscharter.co.za/page.php?p_id=1 (viewed 20 October 2015).

develop the policies and (mandatory) measures that ensure banks are integrating sustainable aspects into their activities.

One example is the Sustainable Banking Network,⁶⁵ which is an informal group of bank regulators and banking associations, led by the IFC, to support regulators in emerging markets to develop regulatory guidance that encourages banks to adopt sustainable banking practices (e.g. for environmental and social risk-management guidelines). The Network shares knowledge, experience and technical resources. It was established after the first International Green Credit Forum in Beijing in May 2012.

At a national level, examples are the Green Finance Task Force convened by China's central bank (2014), which involved many officials and market actors and is followed up by a Green Finance Committee, in order to introduce measures and rules in the different segments of the financial sector.⁶⁶

In France, the Prime Minister's think tank, France Stratégie, has a section dedicated to debates on how the financial system should contribute to energy transition.⁶⁷ It provides an internet platform for experts and non-experts to discuss the merits and the limits of the various proposals and initiatives in the field of international finance.

2.4 Intervention as a strategy by banking supervisors

Example: Central Bank of Kenya

Whether or not supervisors have the mandate to take measures that allow sustainable aspects to be taken into account in a country's banking sector depends on the laws and rules that define their mandate, and the way supervisors interpret those mandates, the resources at their disposal, their ability to monitor trends and their accountability to society. In many countries, central banks are the banking sector supervisors and are often called regulators as they set technical standards and adopt mandatory rules within their remit.

One example is how the Central Bank of Kenya has acted to improve financial inclusion by taking a relatively hands-off approach to enable new non-bank platforms to enter the market while understanding the new business model and the risks involved. As a result, mobile telephone banking and a more diversified and innovative financial sector is providing a wider range of financial services to

65 See also: IFC, IFC Launches Sustainable Banking Network for Regulators to Share Green-Credit Expertise, 26 December 2012, http://www.ifc.org/wps/wcm/connect/industry_ext_content/ifc_external_corporate_site/industries/financial+markets/news/ifc+launches+sustainable+banking+network+for+regulators+to+share+green-credit+expertise (20 October 2015).

66 UNEP Inquiry, <http://web.unep.org/inquiry>: see reports greening China's of the financial sector.

67 <http://www.strategie.gouv.fr/financement-transition-bas-carbone> (18 October 2015).

more people.⁶⁸ The M-KOPA Solar programme is showing the potential for pay-as-you-go mobile payments to provide solar energy in poorer communities.⁶⁹

2.5 Practising sustainable and ethical banking – the direct approach

Examples: Banks and banking alliances: Banca Ethica, Triodos Bank, ASN Bank, GLS Bank, Global Alliance for Banking on Values (GABV), European Federation of Ethical and Alternative Banks (FEBEA), Federação Brasileira das Associações de Bancos (FEBRABAN), many micro-credit and cooperative banking initiatives, Islamic banks, Islamic Development Bank (IDB), 'green sukuk', sustainable and responsible investment sukuk framework (Malaysia)

In recent years, a sustainable or ethical banking sector has emerged. It covers banks that offer depositors the guarantee that their money will not flow towards harmful industries or purposes, such as weapons, nuclear power etc. but will flow to sustainable projects. Some banks also offer alternative investment products.

The various alliances of ethical and sustainable banks are engaged in knowledge-sharing and creating standard operating procedures or benchmarks for their industry. The knowledge sharing of ethical banks not only provides these institutions with more know-how, but it adds more structure and consensus to the discourse of the sustainable finance movement in the form of certain principles or standards that they are expected to abide by.

At the international level, the Global Alliance for Banking on Values (GABV), for example, includes 27 socially responsible banks such as Triodos Bank (The Netherlands) and Banca Etica (Italy), operating in five continents. It also promotes principles such as a 'triple bottom line approach', governance transparency and the need for long-term economic perspectives. The GABV has developed a 'Sustainable Banking Scorecard' based on the six principles of sustainable banking, as a clear and transparent way to measure whether a bank's business model and its use of the balance sheet is according to the principles of sustainability. In addition, it wishes to take a leading role in the debate on how to build a sustainable financial system. It has already called for a fundamental shift in how banks operate to make them more transparent, sustainable and diverse.⁷⁰ It has launched a small campaign #BankingOnValues in October 2014 and October 2015 to influence public opinion and make people familiar with the values-based banking concept. The new GABV 2020 plan includes different advocacy activities from 2016 onwards.

68 UNEP Inquiry, *The Financial System We Need*, p. 19.

69 Frangoul, A., Art. 'Pay-as-you-go Solar Power Takes Off In Africa', CNBC, 25 February 2015, <http://www.cnbc.com/2015/02/25/pay-as-you-go-solar-power-takes-off-in-africa.html> (15 October 2015); see also: <http://www.m-kopa.com/> (20 October 2015).

70 Global Alliance for Banking on Values, *Berlin Declaration 2013 – Transforming the Financial System for stability and a focus on people*, March 2013, http://www.gabv.org/wp-content/uploads/130312_GABV_Berlin_Declaration_EN_final.pdf (20 October 2015).

The European Federation of Ethical and Alternative Banks (FEBEA) assists its members by creating alternative financial tools and by setting up working groups on financing the Global South and microcredit.

At a national level, Brazil's banking association – the Federação Brasileira das Associações de Bancos (FEBRABAN)⁷¹ – has introduced a self-regulation framework.⁷² It has advanced Brazil's domestic dialogue on sustainable finance and has engaged with Brazil's central bank, which led to the BACEN introduction of mandatory requirements for all banks to establish socio-environmental risk systems (see 2.1.1). Assessment by FEBRABAN of financial flows going into the green economy as bank loans, indicate that member banks allocated 8.8% of their balance of operations with corporate clients to green investment in 2013 and 9.5% in 2014.⁷³

In India, the Indian Banking Association is to introduce National Voluntary Guidelines for Responsible Finance in 2015, based on the government's development priorities.⁷⁴ This follows the National Voluntary Guidelines (NVGs) on Social, Environmental and Economic Responsibilities of Business which the Securities and Exchange Board of India (SEBI) mandated in 2012 to be the format for the Annual Business Responsibility Reporting for the top-100 listed companies.⁷⁵

A major initiative from a social sustainability perspective has been micro-finance projects and institutions spread throughout the world, mostly in developing countries but even in some developed countries. Their purpose is to ensure that financial services are reaching the poor and helping them out of poverty through loans. Micro-finance has been supported in different ways, from networking to central bank regulations, and financed from different sources including not-for-profit development NGOs and hedge funds. Micro-finance has been subject to praise and criticism and its achievements seem to be mixed.

Another approach to reaching parts of the population and businesses that are excluded from the mainstream banking sector, has been the different forms of cooperative banking which are still practised, more in developing countries than in developed countries.

It is important to note that a number of states in the US have also established dedicated green banks to promote clean energy and energy efficiency investments including California, Connecticut, Hawaii and New York.⁷⁶ This re-introduces the notion of public banks or publicly sponsored banks to achieve policy goals.⁷⁷

71 UNEP Inquiry, *Ibidem*, p. 21; See also UNEP Inquiry reports on Brazil to download at: <http://unepinquiry.org/?s=&fwpcountries=brazil> (22 October 2015).

72 FEBRABAN. *The Brazilian Financial System and the Green Economy - Alignment with Sustainable Development*, September 2004, <http://www.febraban.org.br/7Rof7SWG6qmyvwJcFwF7I0aSDf9jyV/sitefebraban/The%20Brazilian%20Financial%20System.PDF> (20 October 2015).

73 UNEP Inquiry, *The Financial System We Need*, p. 20.

74 UNEP Inquiry, *Ibidem*, p. 24.

75 Responsible Business India, [website information], <http://responsiblebusinessindia.com/nvgs-the-9-br-principles/#> (20 October 2015).

76 UNEP Inquiry, *Ibidem*, p. 25.

77 See for some background: <http://hubpublicbanking.org/> (20 October 2015).

A new trend has been ethical religion-based finance in the form of Islamic finance. It has been gaining momentum and is worth about US\$2 trillion, making up roughly 1% of the global financial system. Islamic finance incorporates the principles of eschewing interest and debt finance and sharing the risks between suppliers and users of finance. It also bans investment in products or industries that are considered ritually 'unclean', such as alcoholic beverages or pork. Islamic banking could potentially appeal to non-Muslim socially responsible investors. For instance, the development of 'green sukuk' has been part of broader trend of green bonds.⁷⁸ In 2014, the Securities Commission of Malaysia has set up the first sustainable and responsible investment sukuk framework.⁷⁹

A more fundamental approach in voluntary initiatives has been to change the culture of the banks, meaning the values, skills and motivations that drive the behaviour of bank staff and management. This has been little practiced.⁸⁰ One example of addressing the behaviour of banks and their staff is the introduction by the Dutch bank association of voluntary agreements among banks to respect a 'Maatschappelijk statuut' that clarifies how the banks see their role in society, a 'Code Banken' for integer management, and a bankers' oath sworn by each person in a bank to behave integer and at the service of clients.

2.6 Conditioning the funding and guarantees to banks as a strategy to change their lending and project funding

Example: IFC Performance Standards, Reclaiming Public Banks

For lending and the financing of risky projects, or to developing countries, international, regional or governmental development finance institutions (DFIs) provide seed finance or guarantees to banks that are lending. They also provide direct lending to banks and other financial intermediaries that provide loans for such projects or countries. These DFIs include, for example, internationally the World Bank and its private arm the International Financial Corporation (IFC), regionally the Asian Development Bank (ADB) and the European Investment Bank (EIB), and nationally Brazil's Banco Nacional de Desenvolvimento Economico e Social (BENDES). Recently created are the Southern-led BRICS Bank and the Asian Infrastructure Investment Bank (AIIB).

Governments, DFIs and export credit agencies are increasingly reliant on the private sector to deliver development results. For instance, the IFC is estimated to have invested US\$ 36 billion in financial intermediaries between June 2009 and June 2013.⁸¹ The IFC's environmental and social policies

78 Myers, T., Hassanzadeh, E. , The Interconnections Between Islamic Finance and Sustainable Finance, IISD, July 2013, http://www.iisd.org/pdf/2013/interconnections_islamic_sustainable_finance.pdf (20 October 2015).

79 Securities Commission Malaysia, SC Introduces Sustainable and Responsible Investment Sukuk framework, press release, 28 August 2014, http://www.sc.com.my/post_archive/sc-introduces-sustainable-and-responsible-investment-sukuk-framework/ (viewed 15 October 2015).

80 See for instance: UNEP Inquiry, Ibidem, p.xv, 28-29.

81 Bretton Woods Project, Follow the money: The World Bank Group and the use of financial intermediaries, April 2014, http://www.brettonwoodsproject.org/wp-content/uploads/2014/04/B_W_follow_the_money_report_WEB-VERSION.pdf (18 Augustus 2015).

and procedures are developed in its Sustainability Framework (2012) that includes the Performance Standards, Guidance Notes and Interpretation Notes.⁸² According to its Interpretation Note on Financial Intermediaries, banks that are direct clients of the IFC are required to have an environmental and social management system and operate social and environmental assessments for their loans that include IFC financing, contingent on the level of identified social and environmental risks and impacts.⁸³

The European Investment Bank (EIB) also finances the reduction of CO₂ emissions and is developing so-called innovative climate finance solutions including through financial intermediaries such as banks (e.g. the Private Finance for Energy Efficiency instrument). The EIB claims that the tracking of its climate finance is robust.⁸⁴

There are CSO networks that monitor various public financial institutions and expose the social and environmental problems by financial intermediaries loaned to by the DFIs. These include the NGO Forum on the ADB, CEE Bankwatch, CounterBalance, Bank on Human Rights Coalition, etc. For instance, an audit and a critical report of the IFC guidelines shows that its Interpretation Note on Financial Intermediaries is not sufficient to avoid social and environmental risks and they are even not sufficiently implemented, so that the IFC has often no information about the end use of its funds, let alone its social and environmental impact.⁸⁵ CounterBalance concluded that EIB's overall lending, including to financial intermediaries, is not oriented towards sustainable economies and societies, and that the EIB should become a publicly controlled full bank with a banking licence (i.e. it should become a public bank that purposefully competes with private banks).⁸⁶ SOMO and other NGOs have promoted and initiated collective research on the effectiveness of grievance mechanisms of various DFIs, and will advocate for community-led operational-level grievance mechanisms, to support communities suffering from human rights and environmental violations from DFI-sponsored projects.⁸⁷

The Organisation for Economic Co-operation and Development (OECD) to revise its arrangement on export credits that support coal-fired power plants.⁸⁸ The OECD's revision aims to encourage the use of climate-friendly technologies while taking into account the particular needs of less-developed countries. A decision is due before the start of the COP21 Paris summit of the UNCFCCC on

82 IFC, Environmental and Social Performance Standards and Guidance Notes, 2012, http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+sustainability/our+approach/risk+management/performance+standards/environmental+and+social+performance+standards+and+guidance+notes (20 October 2015).

83 IFC, Interpretation Note on Financial Intermediaries, 1 January 2012, http://www.ifc.org/wps/wcm/connect/38d1a68049ddf966af3cbfda80c2ddf3/InterpretationNote_FIs_2012.pdf?MOD=AJPERES (20 October 2015).

84 EIB, Activity report, 2014, p. 35, <http://www.eib.org/infocentre/publications/all/activity-report-2014.htm> (18 August 2015).

85 Bretton Woods Ibidem: Summary; See also for the IFC performance: Oxfam, The Suffering of Others - The Human Cost of the International Finance Corporation's Lending through Financial Intermediaries, April 2015, <https://www.oxfam.org/en/research/suffering-others> (20 October 2015).

86 Counter-Balance, Reclaiming Public Banks, March 2015, p. 19-20, <http://www.counter-balance.org/reclaiming-public-banks-2/> (22 August 2015).

87 See for instance: SOMO, The Patchwork of Non-Judicial Grievance Mechanisms - Addressing the Limitations of the Current Landscape, November 2014, http://www.somo.nl/news-en/the-patchwork-of-non-judicial-grievance-mechanisms/at_download/attachment (20 October 2015); See also: <http://grievancemechanisms.org/>.

88 For more information, see: <http://www.eca-watch.org/node/3600> (18 October 2015).

30 November 2015 but NGOs campaigning for the reform of export credit agencies (ECAs) fear weak OECD arrangements.

2.7 Influencing customers and public opinion as a strategy by civil society to change bank behaviour voluntarily

2.7.1. Ranking of banks by CSOs to influence costumers and public opinion

Examples: Eerlijke bankwijzer, Fair Bank Guide International/Bank Wiser

Consumers are relatively limited in their ability to choose their banks based on ethical or sustainability criteria because they have limited information. The Netherlands, for instance, has a limited number of banks, and switching between them is not always possible. However, reputational damage can be substantial – especially when unsustainable practices are increasingly viewed as risky – and could potentially persuade financial institutions to change their ways.

The reports of the Eerlijke Bankwijzer are specifically focused on Dutch banks and are ranking these banks' behaviour according to various ethical and sustainability criteria. The Fair Bank Guide International initiative has introduced ranking reports to consumers in many other countries, including developing countries such as Indonesia and Brazil. The reports include information on how the banks use savers' money for unethical investments, such as cluster bombs, or behave unethically, for instance, by avoiding taxes or undue behaviour to clients.

Nationally rooted ranking initiative reports provide bank customers with an overview of bank products and activities, ranked according to ethical behaviour, based on which they can decide to leave a bank or take another action. If such actions are done in large numbers and if the media widely reports on scandalous ranking scores, banks could be pressured to voluntarily change their lending and investment behaviour. Also, the reports have been shown to encourage political debates⁸⁹ on the social and environmental sustainability impact of banks.

2.7.2. Public campaigns to make banks stop financing projects and companies that damage the environment and breach human rights

Examples: BankTrack, many different NGOs and international coalitions of NGOs, campaign for a Binding Treaty on Transnational Corporations and Human Rights

Since regulatory and standard-setting bank authorities have for a long time refused to integrate social and environmental criteria for banks, many NGOs have launched campaigns specifically

⁸⁹ See for instance the hearing at the Dutch parliament in September 2014, <http://www.tweedekamer.nl/vergaderingen/commissievergaderingen/details?id=2014A02825>, (20 October 2015).

targeting banks. Such public campaigns aim to raise awareness among the public and customers, and the bank itself, of certain negative effects of a bank financing mechanism in order to increase pressure on the bank and its investors to change their behaviour and reverse financing particular projects or companies.

Many strategies by *BankTrack*⁹⁰ and the coalition of NGOs that BankTrack supports are arguably directly aimed at getting banks to stop financing projects and companies that have detrimental impacts on the environment and human rights ('dodgy deals'). In the run up to the COP21 climate change conference in Paris in December 2015, BankTrack and ally NGOs have launched a successful public campaign to pressure banks to drop financing coal mining and power plants.

Some of the national and international campaigns have been successful strategies to persuade banks to withdraw financing from harmful projects and companies. The drawback is that, for each harmful project or practice, new campaigns are necessary, and voluntary initiatives in response to campaigns, such as the Equator Principles, have been difficult to monitor.⁹¹ A recent trend has been to tackle the lack of binding principles and the impunity of transnational corporations that breach human rights, often by destroying people's livelihoods and environment, by campaigning for a UN treaty that lays down binding obligations for internationally operating corporations regarding human rights and includes a dispute settlement mechanism that results in sanctions for corporations that breach these obligations.⁹² Such a treaty also intends to cover banks, and other financial companies.

90 See: www.banktrack.org.

91 BankTrack, Four steps for the equator principles to regain their ambition and relevance - BankTrack's message to the Equator Principles Annual Meeting in Washington, 19 October 2015, <http://us6.campaign-archive2.com/?u=ca4ff3016df790ab4c04c0ddd&id=3351c149c3&e=a96ea1a845> (19 October 2015).

92 See for instance: <https://www.tni.org/en/publication/8-proposals-for-the-binding-treaty-on-transnational-corporations-and-human-rights> (20 October 2015).

3 Goal: Influencing investors' behaviour

In order to increase the share of capital that goes to the real economy and society in compliance with sustainability criteria, trying to influence the behaviour of investors can have a big impact. Institutional investors control the largest share of a society's available capital and play a potentially important role in allocating capital for sustainable purposes. Individual investors can also be important sources of funding, for instance through their investments in pension funds and mutual funds. Many sustainability initiatives exist for influencing and guiding investors, covering a huge variety of investment instruments and investment strategies.

During the research for this this chapter, it appeared that there was an enormous amount of voluntary initiatives and approaches that support initiatives aiming at directing more investments to sustainably responsible purposes, which could not possibly all be mapped in this report, so that only some examples are provided.

3.1 Mandatory rules as a strategy to impose sustainability criteria on investment funds and other investment instruments

Laws and other legally binding and enforceable regulations and standards are a direct way to make sure that funds and other investment instruments offered to investors take into account social and environmental aspects. Only a few legally binding rules on sustainable investments could be identified for this report.

3.1.1 Mandatory rules for pension funds

Since environmental and social issues can impact the performance and value of investments, understanding these risks could be considered a fiduciary duty for pension funds.⁹³ Also, the pension sector, with its billions of dollars of investments, can have a massive impact on society. Yet the workers who live in these societies and have their savings invested in pension funds have little information and hardly any voice in guiding the investment of their pensions.

In South Africa, the 2011 amendment of Regulation 28 of the Pension Fund Act expanded the concept of the fiduciary duties of pension fund managers. The latter should consider including economic, social and governance (ESG) principles in their asset management policies as they materially affect the sustainable long-term performance of a fund's assets.⁹⁴ There have been attempts made to enforce sustainable reporting by pension funds through legislation.

93 UNEP Inquiry, *The Financial System We Need*, p. 22.

94 Quoted in Alexander, K., *Ibidem*, p. 16; UNEP Inquiry, *Ibidem*, p. 29.

Dutch pension law (*Wet Versterking bestuur pensioenfondsen*)⁹⁵ states that pension funds must report in their annual report on the environmental and social impact of their investment activities. However, both the South African and the Dutch pension fund laws leave room for individual pension funds to determine which ESG factors are of significant importance and how they wish to address these factors in both their policy and reporting efforts – as long as they report on how and if they considered social and environmental factors.

The UK pensions legislation also requires companies to report on whether and how pension funds have applied their fiduciary duty regarding ESG aspects. The UK Law Commission reviewed the fiduciary duties in the investment sphere and confirmed that it is wrong to say that fiduciary investors are under a duty to maximise short-term profit.⁹⁶ Its report found that according to the law, (pension fund) trustees should take into account any factor that is financially material to the performance of an investment, which may include ESG factors. It also found that pension fund trustees may take into account ‘non-financial factors’, such as members’ ethical and quality-of-life concerns, if the trustees have good reason to think that scheme members would share the concern and the decision involves no risk of significant financial detriment to the fund.

At the EU level, a new European pension fund law (IORP II Directive) is being developed, but the proposal that risk assessments for pension funds include ‘a qualitative assessment of new or emerging risks relating to climate change, use of resources and the environment’ (draft Article 29, Para2(h)) is unlikely to be incorporated in the final law text.⁹⁷

3.1.2 Legal requirements for labelled funds

Example: European Social Entrepreneurship Funds (EuSEF) (EU Regulation No 346/2013), Regulation on Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs) (EU Regulation No 1286/2014), Dutch green funds

Many funds have been created that claim to be socially and/or environmentally responsible, but very little regulation exists that ensures that the claims are being honored.

One example to attempt to introduce legally accepted ESG criteria is the EU’s adoption of a Regulation for European Social Entrepreneurship Funds (EuSEF),⁹⁸ which stipulates the requirements by which a fund can be labelled a Social Entrepreneurship Fund and can attract investors from across the EU.

95 Pensioenfederatie, Verantwoord beleggen, [internet information], http://www.pensioenfederatie.nl/services/themas/Pages/Verantwoord_beleggen__37.aspx (20 October 2015).

96 Department for Work and Pensions, Consultation on changes to the Investment Regulations following the Law Commission’s report ‘Fiduciary Duties of Investment Intermediaries, 26 February 2015, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/407937/Condoc_27_02_15_to_DWP.pdf (20 October 2015).

97 See for instance (viewed 15 October 2015): <http://www.ipe.com/news/regulation/iorp-ii-should-mandate-environmental-risk-assessment-urges-shareaction/10009949.fullarticle> and <http://action.shareaction.org/page/-/IORP-II-ECONBriefing.pdf>.

98 For the legal text, see: Official Journal of the European Union, Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European Social Entrepreneurship Funds, 25 April 2013, <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0346&from=EN> (18 October 2015).

The regulation stipulates that social entrepreneurship means the undertaking invests 70% of the funds in the following (Art. 3.1.(d) ii):

- ▣ providing services or goods to vulnerable or marginalised, disadvantaged or excluded persons,
- ▣ employing a method of production of goods or services that embodies its social objective, or
- ▣ providing financial support exclusively to social undertakings as defined in the first two indents.

The EU Regulation on Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs) stipulates (Art. 8.3.(c) (ii) that a complex investment fund on sale for individual investors needs to mention, if applicable, whether a fund targets specific environmental or social objectives, while also having to explain in what assets the fund invests in. By 31 December 2018, the European Commission has to determine (Art. 33.1.) whether a non-legislative or law-based label for social and environmental investments is feasible, amongst others by reviewing the whether the EuSEF legislation generated positive social impacts.

Dutch green funds are subject to legal requirements as explained below (see: 3.3).

3.1.3 Legally binding rules for investors in commodity derivatives markets

Examples: MiFIDII- MiFIR (EU), Dodd-Frank Act (US)

Given that the prices of commodities and especially food determine what poor households can afford, as well as what income commodity exporting countries and small farmers can receive, food price speculation has been criticised since 2007-2008 for food price hikes and volatility. It had come under increasing scrutiny from civil society and some of the responsible investment community⁹⁹, which added pressure to regulate the commodity derivatives market.

The new EU laws on financial markets that cover commodity derivatives markets, (MiFIDII - MiFIR (2014)), introduce limits on the number of contracts that are speculating through commodity derivatives, i.e. not trading to hedge the price of physical commodities it is trading.¹⁰⁰ The purpose is to avoid that too many financial players cause too much price volatility that harms the price-setting and hedging functions of the commodity derivatives markets, thereby harming farmers and poor consumers when volatility results in too high prices. Also the US Dodd-Frank Act has made the position limits stricter in order to close loopholes in the application of its existing position limits.¹⁰¹ India banned commodity derivatives trading at the time prices were hiking and speculation might result in too high prices unaffordable for the poor.¹⁰²

99 See also: Clapp, J., *Ibidem*: Initiatives include the Responsible Investor's Guide to Commodities (2011) and the Guidelines for Responsible Investing in Food Commodities (2012) by Interfaith Center on Corporate Responsibility (ICCR).

100 See for instance: Vander Stichele, M., Financial Instruments and Legal Frameworks of Derivatives Markets in EU Agriculture: Current State of Play and Future Perspectives, July 2014, European Parliament Study, [http://www.europarl.europa.eu/RegData/etudes/STUD/2014/514008/IPOL_STU\(2014\)514008_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2014/514008/IPOL_STU(2014)514008_EN.pdf) (22 August 2015).

101 See for instance: Vander Stichele, M., *Ibidem*.

102 See for instance: Vander Stichele, M., *Ibidem*.

3.1.4 Mandatory reporting by investors

Examples: French Energy Transition Law, SEC Interpretative Guidance on Disclosure Related to Business or Legal Developments Regarding Climate Change, EU Directive regarding the disclosure of non-financial and diversity information by certain businesses

One of the first steps to introduce sustainability into the investment world has been to provide more transparency of their investments and their impacts, especially regarding social and environmental impacts. Only a few transparency requirements have been enshrined in clear legal requirements.

A recent step has been the May 2015 Energy Transition Law in France, which requires that the annual reports of investors should include information about how their investment decision-making process takes ESG criteria into consideration, and their contribution to the financing of the ecological and energy transition.¹⁰³

In 2010, the American Securities and Exchange Commission (SEC) published its Interpretative Guidance on Disclosure Related to Business or Legal Developments Regarding Climate Change.¹⁰⁴ SEC regulations require companies to disclose information on climate change issues for the benefit of investors. The focus was material risks to shareholder value such as the impact of environmental legislation and regulation, the possible impact of international accords to prevent climate change, regulative and business trends, and the material impact of a changing climate. Appropriate disclosure should therefore cover all information – including non-financial information that could potentially have financial impact – that benefits their investors. After going through 3,895 annual reports of American companies, a citizen researcher¹⁰⁵ found that almost 75% ignored the Commission guidelines. And out of the companies that acknowledged ‘global warming’ or ‘climate change’, few disclosed real specifics. To avoid such practice, the guidance on climate disclosure through the SEC is to be matched by robust disclosure guidance from the Sustainability Accounting Standards Board for corporations using the SEC’s definitions of materiality.

Similarly, in 2014 an EU law was adopted regarding the disclosure of non-financial and diversity information by certain large businesses. Many but not all large businesses, including insurance and asset management companies, with over 500 employees are now required to disclose to their shareholders and other investors information on ‘policies, risks and outcomes as regards environmental matters, social and employee-related aspects, respect for human rights, anti-corruption and bribery issues, and diversity in their board of directors’.¹⁰⁶ The directive does, however, leave significant flexibility for companies to disclose relevant information in a way that they consider most useful.

103 UNEP Inquiry, *Ibidem*, p.27.

104 SEC, Commission Guidance Regarding Disclosure Related to Climate Change, 2010, <http://www.sec.gov/rules/interp/2010/33-9106.pdf> (20 October 2015).

105 Hirji, Z, Art. ‘Most U.S. Companies Ignoring SEC Rule to Disclose Climate Risks’, *InsideClimate News*, 2013, <http://insideclimatenews.org/news/20130919/most-us-companies-ignoring-sec-rule-disclose-climate-risks> (20 October 2015).

106 European Commission, Non-Financial Reporting, [October 2014], http://ec.europa.eu/finance/company-reporting/non-financial-reporting/index_en.htm (16 October 2015).

A 2014 study by the UNEP Inquiry¹⁰⁷ and a study jointly published by the UNEP FI and the Cambridge University Institute for Sustainability Leadership¹⁰⁸ provides a good overview of existing measures (by mid 2014) that are not targeted directly at banks, but at companies listed on securities exchanges (see Table 3).

Table 3: Listing requirements/regulation affecting disclosures for financial markets, by 2014

Country	Name of framework	Scope	Targeted constituency
EU	Directive regarding the disclosure of non-financial and diversity information by certain businesses (Directive 2014/95/EU)	Disclosure of non-financial and diversity information, incl. policies, risks and outcomes as regards environmental matters, social and employee-related aspects, respect for human rights, anti-corruption and bribery issues, diversity in the board	Certain large businesses, including banks and insurance companies, with over 500 employees
France	New Economic Regulations Act (NRE) (2001)	Requirement to disclose in annual report how companies address social and environmental impacts	Companies whose securities can be traded on a regulated market
	NRE implementing Decree; and ministerial order (2002)	Reporting according to a list of 19 environmental and social topics; and emissions and pollution	Companies whose securities can be traded on a regulated market
	Grenelle II Act, followed by Decree regarding sustainability reporting requirements (2010)	Corporate sustainability reporting; requirement to disclose certain environmental and social information and information relating to sustainable development commitments; or provide substantive information on why certain data is not reported	All listed companies and companies with an annual balance and turnover of €100 million and an average of 500 permanent employees
UK	Companies Act (2006)	Requirements to report on environmental, workplace, social and community matters that are material to their business	Companies listed on the London Stock Exchange
	Climate Change Act (2008)	Report CO ₂ emissions on an annual basis	Listed companies
	Combined Code on Corporate Governance (2012)	Corporate governance; Guiding principles; contains listing rules, requiring listed companies to apply and report on main principles; voluntary for wider private sector	Listed companies
USA	SEC Commission Guidance Regarding Disclosure Related to Climate Change	Disclosure related to Climate Change Issues as regards: compliance with environmental laws; risk investment; liquidity, capital resources and results of operations; material risks; environmental issues affectation to assets	Public companies and foreign private issuers

Source: These tables are primarily extracted from Alexander, K., *Stability and Sustainability in Banking Reform: Are environmental risks missing in Basel III?*, University of Cambridge Institute for Sustainability Leadership (CISL), August 2014. Some additional information was taken from UNEP Inquiry, *Aligning the Financial System with Sustainable Development: Insights from Practice*, 2014, and Eurosif, *EU Non-Financial Disclosure Related Regulation Overview*, 19 March 2015.

107 UNEP Inquiry, *Aligning the Financial System with Sustainable Development*, October 2014.

108 Alexander, K., *Ibidem*.

Although financial reporting to investors is an essential but not determining condition to make investors choose more sustainable options, few regulatory reporting requirements so far seem robust enough to form a comprehensive and reliable basis for investment decision making.

3.1.5 Civil society advocacy and campaign strategies for mandatory regulation and policies regarding investment in particular assets

Examples: FinanceWatch, Friends of the Earth, SOMO, WDM, Corporate Europe Observatory, UK Transforming Finance Network, ShareAction, FERN, Global Witness

One example of an NGO campaign for regulating investments was the lobby, advocacy and popularisation work aimed at banning or at least limiting food price speculation through the speculative trading of food commodity derivatives. Different NGOs engaged in lobbying specific provisions during the EU decision-making process to revise the Markets in Financial Instruments Directive and Regulation (MiFID II - MiFIR). At the time of voting in the European Parliament and decision-making with the Ministers of Finance, campaign groups joined in with letter writing and street actions. The end result was that position limits were imposed on speculative traders in commodity derivatives in the legislation, even though loopholes are weakening the effectiveness.

Targetting the many different investors that are involved in harmful financing of land acquisitions that adversely affect people and the environment ('land grab'), FERN, Global Witness and Friends of the Earth Europe are at the core of an informal network that advocates the introduction of mandatory rules to prevent such predatory investment in particular and regulations the oblige investors to assess and manage ESG risks, in general.¹⁰⁹

Another example of NGO advocacy for better regulation in a specific sector is the UK's ShareAction, which researches and advocates for structural recommendations made to policy-makers to improve the performance of the pension sector. For instance, it points out that the regulatory environment makes it difficult for pension funds to consider long-term risks like climate change, in turn encouraging a focus on the short term.

¹⁰⁹ See for instance: Euroactiv, EU votes on shareholder measures to tackle reckless companies, 2 June 2015, <http://www.euractiv.com/sections/social-europe-jobs/eu-votes-shareholder-measures-tackle-reckless-companies-315057> (20 October 2015).

3.2 Intervention by regulators and supervisors in the insurance sector

Example: Bank of England

The insurance and re-insurance industries are aware that they are and will be impacted by natural disasters and the physical impacts of climate change. However, they might be less aware of how they will be impacted by the low-carbon transition.

The Bank of England, as supervisor of the UK insurance sector, has required insurance companies to assess the impact of climate change for the ‘safety and soundness’ of insurance companies and the protection of policy-holders.¹¹⁰ Concerns include the costs the insurance industry faces to pay for the consequences of extreme weather, e.g. due to damage on real estate investments from heavy storms and other phenomena of climate change. As a supervisor who wants to avoid abrupt changes that undermine financial stability, the Bank of England calls it ‘a market failure’ that there is not enough information ‘about carbon effects on trillions and trillions of dollars of potential investments’, or potential ‘stranded assets’.¹¹¹ This Bank of England initiative of a prudential review of climate risk in the insurance sector has contributed to a G20 mandate whereby the Financial Stability Board (composed of supervisors of G20 and some other countries) is considering climate risks since 2015.¹¹² A recent report¹¹³ into insurance sector exposure to climate risk highlighted possible future risks relating to greenhouse gas emission liability, but it finds that the insurance sector, so far, appears to be managing climate change as you would expect for an industry that is meant to ‘peer into the future’.

Since 2002, Indian insurance firms have been required to satisfy quotas for the extension of insurance coverage to low-income and rural clients.¹¹⁴

110 Bank of England. Supervisory activities – Climate Change Adaptation Reporting, [website information], <http://www.bankofengland.co.uk/pru/Pages/supervision/activities/climatechange.aspx> (20 October 2015); Fisher, P., Confronting the challenges of tomorrow's world. Prudential Regulation Authority, [Speech], 3 March 2015, <http://www.bankofengland.co.uk/publications/Documents/speeches/2015/speech804.pdf> (20 October 2015); Further details of the review, and in due course its ultimate output, will be published at <http://www.bankofengland.co.uk/pru/Pages/supervision/activities/climatechange.aspx>.

111 Palmer, R., Art. ‘Bank of England head rebuts critics of his global warming remarks’, Reuters, 8 October 2015, <http://www.reuters.com/article/2015/10/08/us-imf-boe-idUSKCN0S239620151008> (9 October 2015).

112 UNEP Inquiry, The Financial System We Need, p. 5.

113 Bank of England, The impact of climate change on the UK insurance sector - A Climate Change Adaptation Report by the Prudential Regulation Authority, September 2015, <http://www.bankofengland.co.uk/pru/Documents/supervision/activities/pradefra0915.pdf> (20 October 2015).

114 UNEP Inquiry, The Financial System We Need, p. 26.

3.3 Fiscal incentives as an approach to influencing the direction of investments

Example: Dutch green funds

Another way by which public authorities can influence the conduct of the financial institutions, investors and customers is by creating incentives for sustainable financing and investment. Such incentives can be in the form of subsidies, tax deductions or other fiscal measures, loan guarantees, waivers in existing standards, etc.

One example to illustrate a current governmental fiscal measure is the Dutch regulation (regeling groenfondsen) or 'green funds' offered by banks or others to individual investors. The investors in these funds do not have to pay taxes on the returns from them up to a certain value of the green investments. The issuers of those funds have to finance companies or projects that are accepted as sustainable, based on standards defined by the government. However, too lax standards have been criticized as resulting in abusive practices and non-sustainable outcomes.¹¹⁵

China's plans to offer partial tax exemptions on investors' gains when investing in the domestic green bond market that aims to finance infrastructure.¹¹⁶

3.4 Voluntary measures to provide sustainability-related information that can influence investors

There are different ways of and approaches to providing investors with information about a company's social and environmental risks, its carbon footprint, its policies for ensuring compliance with standards of 'corporate social (and environmental) responsibility' and so on. The first reporting on the social and environmental dimensions of corporate performance started when the 1992 Earth Summit first internationally recognised the need to encourage improved transparency.

The disclosure initiatives discussed below are examples of those developed by the financial industry or non-profit organisations, and complement those mentioned above that were mandatory requirements. Organisations that opt to provide investors and others (in the financial markets) with information on ESG issues normally assume that: (1) this information is lacking, and (2) market actors would act differently when provided with adequate information. They consider that creating a better understanding of the financial risks associated with social and environmental damage is vital to the advancement of a more just and sustainable financial sector and general economy. An overall comment on the impact of transparency can be found at the end of this section.

115 Cohen, R., Den Daas, S., Art. 'Fiscale voordelen groene beleggingen onder vuur', Het Financieele Dagblad, 9 February 2015.

116 UNEP Inquiry, Ibidem, p. 23.

3.4.1 Voluntary sustainability indices, labels and disclosure commitments

Examples: Carbon Disclosure Project (CDP), Carbon Tracker Initiative, The Sustainability Report (Australia), Standard & Poor's Dow Jones Sustainability Indices, Novethic SRI Label, Novethic Green Fund Label, UNEP FI Human Rights Guidance Tool for the Financial Sector

Traditional sources of market information such as credit rating agencies (CRAs, see also below) and popular market indices are known to reveal little to nothing about the social and environmental risks that business are exposed to. Several initiatives have been established to address this perceived lack of adequate information.

In 1999 the Dow Jones Sustainability Indices were established, identifying leaders in sustainability across all sectors using a best-in-class approach.¹¹⁷

As there is no official initiative that verifies the criteria used by funds labelled as socially and environmentally responsible, Novethic introduced in 2009 a certification of such funds in the EU. Novethic awards the SRI label to funds that 'systematically integrate environmental, social and governance criteria in their management and that guarantee a high degree of transparency in the SRI management processes used.'¹¹⁸ Novethic more recently introduced the "Novethic Green Fund Label" to funds that select companies on the basis of environmental criteria, which have been independently verified, and that meet transparency, social and governance criteria.¹¹⁹

In an effort to provide investors with vital environmental market information, the Carbon Disclosure Project (CDP)¹²⁰ requests their members to disclose carbon, forest, water and natural capital information. The CDP is currently backed by 767 institutional investors, representing US\$ 92 trillion in assets. While the CDP actively engages business and investors by providing them with a frame-work to report environmental risks, other initiatives have opted for a less interactive approach. The Carbon Tracker Initiative¹²¹, Australia's Sustainability Report¹²² and UNEP's Human Rights Guidance Tool for the Financial Sector¹²³ choose to mainly publish reports on social and environmental risks associated with specific investments. The Sustainability Report (Australia) provides investors with weekly updates on ESG issues related to companies listed on the Australian Stock Exchange. The carbon bubble initiatives that have recently drawn more attention to investment in fossil fuels, are an

117 Dow Jones Indexes, Sam Indexes, Stoxx Ltd, Dow Jones Sustainability Indexes. The First Decade: 1999-2009, 2009, <https://www.idmarch.org/document/Sustainable+Asset+Management/4aDM-show/The+First+Decade%3A++1999-2009> (20 October 2015).

118 For more information see: <http://www.novethic.com/socially-responsible-investment/french-european-sri/sri-market.html> (20 October 2015).

119 For more information, see: <http://www.novethic.com/socially-responsible-investment/environmental-funds/sri-market.html> (20 October 2015).

120 <https://www.cdp.net/en-US/Pages/HomePage.aspx> (20 October 2015).

121 <http://www.carbontracker.org/> (20 October 2015).

122 <http://www.thesustainabilityreport.com.au/> (15 June 2014).

123 <http://www.unepfi.org/humanrightstoolkit/> (15 June 2014).

interesting case. For instance, studies by the Green European Foundation¹²⁴ and the Carbon Tracker Initiative,¹²⁵ have provoked responses ranging from serious concern to blatant dismissal.

3.4.2 Voluntary listing and company requirements to inform shareholders and investors

Examples: BOVESPA's Corporate Sustainability Index (ISE, Brazil), Sustainable Stock Exchange Initiative

Stock exchanges, which are private companies, can make sustainability-related disclosures obligatory as part of the requirements to provide information to the investing public (see also Table 3 above.)

An early market-driven initiative was Brazil's stock exchange BOVESPA, which created the Corporate Sustainability Index (ISE) in 2005 by which it associated performance with access to capital-raising opportunities.¹²⁶ Another such initiative was introduced by the Johannesburg Stock Exchange (JSE) in South Africa, linking comparable requirements to the King Code of Governance. In 2012, the Singapore Stock exchange released guidance on sustainability reporting for listed companies, and plans to impose penalties for poor reporting.¹²⁷

Globally, 24 stock exchanges around the world have committed to enhanced disclosure of sustainability aspects as members of the Sustainable Stock Exchange Initiative that was co-convened by UNEP, UNCTAD and the UN Global Compact.

3.4.3 Voluntary sustainable reporting initiatives to assess the social and environmental risks

Examples: Global Reporting Initiative (GRI), Institutional Investor Group on Climate Change (IIGCC), Carbon Disclosure Project, Eurosif's Transparency Code, Bloomberg New Energy Finance, Climate Disclosure Standards Board (CDSB), Sustainability Accounting Standards Board (SASB)

Organisations and businesses wanting to provide sustainable information to interested investors have similar motivations to organisations providing market information to investors: information is key. Given that little to no information was available through traditional legal standards about negative impacts, sustainable reporting and risk assessment frameworks were developed. The Institutional Investor Group on Climate Change (IIGCC), a European network organisation

124 Green European Foundation et al., *The Price of Doing Too Little Too Late: The impact of the carbon bubble on the EU financial system*, 2014, <http://sustainablefinancelab.nl/files/2014/03/SFL-GND-Carbon-Bubble.pdf> (8 December 2014).

125 Carbon Tracker Initiative, *Unburnable Carbon – Are the world's financial market carrying a carbon bubble?*, 2014, <http://www.carbontracker.org/site/wp-content/uploads/2014/05/Unburnable-Carbon-Full-rev2-1.pdf> (20 October 2015).

126 UNEP Inquiry, *The Financial System We Need*, p. 21.

127 UNEP Inquiry, *Idem.* .

for institutional investors, argued that '[c]orporate disclosure frameworks provide sector-specific reporting guidelines for companies which will make it easier for investors to assess and compare the risks and opportunities posed by climate change and climate policy to individual companies'.¹²⁸

The UN Principles for Responsible Investment (see 1.1, Table 1) include voluntary assessment and reporting frameworks and have been important at the international level.

The European Sustainable Investment Forum (Eurosif)¹²⁹ is a sustainable and responsible investment (SRI) organisation, working together with national Sustainable Investment Forums (SIFs).¹³⁰ Its members are a combination of institutional investors, asset managers, SRI initiatives and NGOs. Together these members are worth around €1 trillion. The pan-European network and think tank was created with the goal of developing sustainability through European financial markets. As a part of their push for ESG disclosure by asset owners and institutional investors, Eurosif members introduced their Transparency Code in 2004. Signatories of the Eurosif Transparency Code are to produce an annual document in which they state that they are committed to responsible and sustainable investing and subsequently answer detailed questions regarding the role of ESG issues in their investments. Eurosif currently has 50 signatories.

Similarly, the Global Reporting Initiative (GRI)¹³¹ offers companies the tools to report on their impact on social, economic, environmental and governance issues. It has also issued supplementary guidance on the application of its principles that is tailored specifically to reporting by the financial services industry.¹³²

Eurosif and GRI do not specifically report on the performance of their tool.

The Carbon Disclosure Project (see 3.4.1) can also be categorised as a reporting tool, as it requires its members to regularly report on environmental information related to their business activities.

A very issue-specific commercial but free initiative is the IAN¹³³, which attempts to assess 'tenure risk' and land-based projects, for instance, when they are opposed by local populations.

The Bloomberg New Energy Finance is a commercial initiative that informs about renewable energy and provides 'analysis, tools and data' for investors, traders and other professionals in the financial industry, as well as researchers, regulatory authorities and non-financial businesses.¹³⁴

128 IIGCC, Corporate Climate Risk Management, [website information], <http://www.iigcc.org/publications/category/Corporate-Climate-Risk-Management> (20 October 2015).

129 <http://www.eurosif.org/> (20 October 2015).

130 Eurosif has partnered with Belsif (Belgium), FNG (Austria, Germany and Switzerland), FFS (Italy), Swesif (Sweden), UKSIF (the United Kingdom), VBDO (the Netherlands). European SIFs that do not work with Eurosif are Dansif (Denmark) and Finsif (Finland).

131 <https://www.globalreporting.org/Pages/default.aspx> (20 October 2015).

132 GRI, Sustainability Reporting Guidelines & Financial Services Sector Supplement, <https://www.globalreporting.org/resource/library/G3-English-Financial-Services-Sector-Supplement.pdf> (20 October 2015).

133 <http://www.tmpsyste.ms.net/ian> (20 October 2015).

134 For more information, see: <http://about.newenergyfinance.com/about/>

The Climate Disclosure Standards Board (CDSB), Sustainability Accounting Standards Board (SASB) and others are developing new frameworks for sustainability and climate accounting and disclosure.¹³⁵ Indeed, there seems to be a need for uniformity since the CDSB argues that there are almost 400 different provisions that directly or indirectly affect the reporting of complementary information, such as environmental and social requirements. However, they might still not include material issues, such as the impact of extreme weather, natural disasters, or potentially the decrease of value of assets related to in high carbon sectors ('asset stranding').¹³⁶

3.4.4 Commercial sustainable rating agencies

Examples: Sustainable Investment Research International (SIRI) Group, EIRIS, Vigeo, Sustainalytics, Oekom Research, Ethibel

In recent years, we have seen the emergence of an entire industry around sustainable or ethical investment. The services include consultancies, such as Ethibel, that offer sustainability ratings¹³⁷ to banks and other financial institutes regarding the companies or assets they want to invest in.

The traditional credit rating agencies (CRAs) have responded to investor demand given the increasing impact on the value of investments ('materiality') by social and environmental factors, and have published research about those factors. For instance, US-based CRA Standard & Poor's published numerous reports on climate change and identified climate change as one of the two megatrends, alongside demographics, affecting the risks for investments in sovereign bonds.¹³⁸

Sustainable rating agencies (see list of examples), as do rating agencies in general, provide 'infra-structural services' to financial investors by helping them to navigate the vast sea of investment opportunities.¹³⁹ The sustainability rating industry is not yet nearly as oligopolistic as the conventional credit rating industry where only three companies control the market, but it appears that centralisation is also taking place there.¹⁴⁰ The Sustainable Investment Research International (SIRI) Group brings many of them together. EIRIS and Vigeo, an UK respectively a French ESG research agency, announced on 13 October 2015 to merge.¹⁴¹ This could be another step in the consolidation of the sustainable finance information sector and could result in sustainable investors having decreasing choice

135 UNEP Inquiry, *The Financial System We Need*, p. 21.

136 UNEP Inquiry, *Idem*.

137 For further information on the market for sustainability ratings: Novethic, *Overview of ESG Rating Agencies*, October 2014, http://www.novethic.com/fileadmin/user_upload/tx_ausynovethicetudes/pdf_complets/2014_Overview-of-ESG-rating-agencies.pdf (15 November 2014).

138 UNEP Inquiry, *Ibidem*, p. 23; Standard and Poor's, *Climate Change is a Global Mega-trend for Sovereign Risk*, 15 May 2014, https://www.globalcreditportal.com/ratingsdirect/renderArticle.do?articleId=1318252&SctArtId=236925&from=CM&ns_code=LIME&sourceObjectId=8606813&sourceRevId=1&fee_ind=N&exp_date=20240514-20:34:43 (20 October 2015).

139 Nölke, A., Perry, J., Art. 'Coordination service firms and the erosion of Rhenish capitalism', *The Transnational Politics of Corporate Governance Regulation*, Milton Park: Routledge, 2007.

140 Novethic, *Ibidem*, p. 4.

141 http://www.eiris.org/wp-content/uploads/2015/10/20151012-PressBook-Vigeo_EIRIS_Merger.pdf (20 October 2015).

between different ratings from various agencies. In different countries, such as Canada or Australia, there are also schemes that provide certification of responsible investment advisors.

3.4.5 Critical comments

The overview above exposed a huge amount of different sustainability information instruments available. However, the question remains how, and how much, can the provision of information possibly change the behaviour of those investing in companies and all other assets that affect social and environmental sustainability? First of all, information tools as such, perhaps apart from certain ranking initiatives, are non-confrontational. Second, this development of voluntary transparency initiatives can be seen to hold the promise that the market can come up with solutions to the challenges posed by environmental degradation and the social consequences of economic action. This would obviate the need for far-reaching regulation, leaving governments the task of ensuring that the market works and possibly of promoting a sustainability-oriented financial industry through positive measures like subsidies or tax breaks. Third, sustainability-related information is necessary to make sure that these investors can send their money in the right direction – but what guarantee do they have that they have any direct positive effects? For instance, through sustainability rating agencies, investors rely on the agencies that do the work for them and to summarise their findings in an easily understandable form: are the single three-letter credit (or sustainability) ratings the right form to cover all the necessary information or only available information without in situ research?

UNEP Inquiry concludes that ‘while adoption of sustainability reporting has become common the potential for significant impact remains unfulfilled’ as systematic social and environmental improved performances on the ground are not clear.

Ironically, for those primarily interested in financial returns, social and environmental information might be of interest since businesses and individuals who promote sustainable finance often argue that sustainable business practices are not just ethically, but also financially superior and can generate better returns for financial investors in the longer term.¹⁴² Arguments behind such thinking is that businesses that harm their social or natural environment incur more costs in the medium to long term, whether in the form of dissatisfied and unmotivated workers, investment risk that arises from angering local communities, legal fees and fines for breaching labour or environmental law and so on. Thus, investors would no longer have to be ethically minded nor need an incentive to appreciate the usefulness of sustainability-related information.

142 E.g. Global Alliance for Banking on Values, Real Economy – Real Returns: The Business Case for Sustainability Focused Banking, October 2014, www.gabv.org/wp-content/uploads/Real-Economy-Real>Returns-GABV-Research-2014.pdf (16 November 2014).

3.5 Voluntary codes of conduct – a broadly used approach

Examples: The OECD Proactive Agenda Project on Responsible Business Conduct in the Financial Sector, Climate Principles, Carbon Principles, Responsible Investor's Guide to Commodities, Guidelines for Responsible Investing in Food Commodities

(NB: see also the UN initiatives included in Chapter 1.1: UN Global Compact, UN Principles for Responsible Investment (UN PRI), UNEP Principles of Sustainable Insurance (PSI), UN Guiding Principles on Business and Human Rights)

Since their introduction, voluntary codes of conduct have become an increasingly popular tool to address issues of sustainability by investors. Only a few codes that apply for financial and institutional investors are being mentioned here. Many financial investors apply their own sustainability codes of conduct.

The OECD Guidelines for Multinational Enterprises (the Guidelines, 1976) offer a multilaterally agreed voluntary corporate responsibility instrument for globally operating companies, which adhering governments have committed to promote.¹⁴³ In mid-2015, the OECD initiated the second phase of a 'Proactive Agenda' project on Responsible Business Conduct in the Financial Sector.¹⁴⁴ The OECD's project was initiated following a controversial OECD Guidelines case¹⁴⁵ filed against pension funds for minority shareholdings they had in a destructive iron ore mine and steel factory. The case – and a subsequent clarification from the OECD – clarified that financial investors such as pension funds are responsible for seeking to prevent or mitigate the negative impacts of the projects they invest in.¹⁴⁶ The Proactive Agenda Project aims to elaborate how different parts of the financial sector may integrate the provisions of the Guidelines into their due diligence practices, with particular focus on operations, products and services that contribute to or are directly linked to adverse human rights, labour or environmental impacts through a business relationship.

Voluntary codes of conduct such as the Carbon Principles and the Climate Principles provide private financial institutions with tools to more adequately assess social and especially environmental risks but are specifically directed at establishing a low-carbon economy. The Carbon Principles and the Climate Principles were established by leading private financial institutions.

Voluntary codes for specific assets include the Responsible Investor's Guide to Commodities (2011), which is a joint initiative of the UN Global Compact, the UN PRI, the Swiss government, and the consultancy OnValues.¹⁴⁷ The guide maps best practices for institutional investors seeking returns from investments in commodity derivatives, physical commodities, and farmland, as well as debt and equity in agricultural commodity producing firms. Its recommendations feature transparency and the

143 OECD, OECD Guidelines for Multinational Enterprises: Responsible Business Conduct Matters, 2014, p. 2.

144 See also the preparatory conference: <https://mneguidelines.oecd.org/globalforumonresponsiblebusinessconduct/GFRBC-2014-financial-sector-document-2.pdf> (20 October 2015).

145 See: http://oecdwatch.org/cases/Case_261 (20 October 2015).

146 OECD, Due diligence in the financial sector: adverse impacts directly linked to financial sector operations, products or services by a business relationship, 2014, <https://mneguidelines.oecd.org/globalforumonresponsiblebusinessconduct/GFRBC-2014-financial-sector-document-1.pdf> (7 December 2014).

147 Clapp, J, *Ibidem*.

establishment and maintenance of ESG standards along commodity chains. It acknowledges that negative social and environmental externalities associated with financial investment are possible, and warns that the lack of responsible investment to avoid those costs could 'ultimately harm investors'.¹⁴⁸ The Guidelines for Responsible Investing in Food Commodities introduced in 2012 by the Interfaith Center on Corporate Responsibility (ICCR) are much more restrictive.¹⁴⁹

3.5.1 Some critical comments

The voluntary guidelines that were mentioned in this report are mostly industry driven and offer little information on their performance or even about the number of institutions adhering to them. Many commentators question whether the voluntary guidelines can bring about the structural changes that are necessary to support the transition to a sustainable financial sector and have little proof of concrete impacts on the financial sector's behaviour in terms of impacts on social and environmental sustainability. A major criticism is the lack of accountability. Sustainable Living Fabrics, in a document available through the Global Compact website, argues that greenwashing and free-riding remains one of biggest challenges in voluntarily adopting sustainable investment policies.¹⁵⁰ Indeed no sanctions are applied in case of non-compliance. Voluntary codes of conduct rely heavily on the assumption that the people working in the financial and other sectors will do the morally right or when subject to a mild form of external peer pressure. Given other, more sustained, pressures on commercial companies especially the financial sector, where huge profits are a strong drive, this is clearly a weak approach and sociologically naïve., also a study about bank staff behaviour in the Netherlands found out.¹⁵¹

A legitimate question is whether voluntary codes – which are self-regulatory tools – are perhaps part of a bigger strategy or tendency towards self-regulation by the financial industry and other businesses that would make formal and binding regulation unnecessary. It might be a reflection of what could be seen as an *alliance* between public and private financial actors whereby national financial regulators face strong incentives to ensure the stability of their financial sector while also maintaining its competitive position in the global financial market. Such a framework can be seen as an updated form of the 'regulatory capture' framework, i.e. rules shaped by those who have to be regulated.

148 Clapp, J, Ibidem.

149 Clapp, J. Ibidem.

150 Sustainable Living Fabrics, Sustainability Report 2009, 2009, p. 7, http://www.unglobalcompact.org/system/attachments/8495/original/SLF_Sustainability_Report_2009.pdf?1290036155 (10 June 2014).

151 Van Staveren, I., Van Tilburg, R., Bankers Focus on Clients – But What Do Bankers Do?, June 2015, http://sustainablefinancelab.nl/files/2015/06/SFL_survey2014_ENGLISH_EA.pdf (20 October 2015): the study found out that bank staff were willing to put the client at the centre of their services but that bank management gave priority to achieving hard core financial targets.

3.6 Strategies to ensure that investment has direct social and environmental impact

Some new particular public-private initiatives are attempting to have, and to prove to have, a real social or environmental impact. They complement existing private sector practices of social and environmental investment institutes and networks.

3.6.1 The new strategy of public-private initiatives for social and environmental impact investments

Examples: Impact investment, social impact bonds, development impact bonds, Climate Bonds Initiative, Network for Sustainable Markets, World Bank Green Bonds, Green Bond Principles, Natural Capital Financial Facility

Beyond voluntary codes and policies, there are initiatives that focus on investments having a real pre-defined social or environmental impact and that therefore include instruments of impact measurement.

So-called impact investment covers investments made into companies, organisations and funds with the intention of having a concrete social and environmental impact while at the same time providing a financial return below market or at market rate level, or at a minimum a return of the invested capital. Impact investments aim to have a positive effect on, for instance, sustainable agriculture, affordable housing, affordable and accessible healthcare, clean technology and financial services.¹⁵² Characteristics include investor measurements and reports on the social and environmental performance and progress of the investment.

A new trend that seems to be on the rise is social impact bonds that are a particular form of social investment that has started in the UK (2010).¹⁵³ Social impact bonds are contracts between investors and the public sector with a commitment to pay for improved social outcomes, for instance, to reduce homelessness or improve crime recidivism. They intend to save public finances by avoiding initial payments and reduced payment in the case of failure. They cover a fixed period of time but do not offer a fixed rate of return as bonds usually do. However, only if specified social outcomes have been achieved does the government repay the investors the initial investment plus a return for the financial risks they took. Development impact bonds are similar to social impact bonds, aiming to achieve social outcomes in developing countries through new sources of financing. Critics of social impact bonds point out that the social and environmental objectives might be too narrowly defined. Moreover, there are doubts about whether the complexity of the instruments and measurements,

152 As explained by the Global Impact Investing Network (GIIN), <http://www.thegiin.org/cgi-bin/iowa/resources/about/index.html> (4 December 2014).

153 For a detailed explanation, see: <http://www.socialfinance.org.uk/wp-content/uploads/2015/05/Introduction-to-Social-Impact-Bonds.pdf> (4 December 2014).

and the repayment by the government to the investor with an additional return for the risk taken, really results in saving public finances.¹⁵⁴

Green bonds, or climate bonds, are bonds that are issued in order to raise capital for environmental solutions. These types of bonds have gained popularity in recent years. In order to address climate change, the World Bank started issuing green bonds in 2008 and has since issued US\$ 6.4 billion worth of green bonds.¹⁵⁵ Together with the Network for Sustainable Markets, the Climate Bonds Initiative aims to promote the use of green bonds among investors. Critics complain that the voluntary guidelines are not strict enough and are subject to abuse.¹⁵⁶ In order to protect the integrity and promote the transparency of green bonds, the Green Bond Principles are a voluntary set of guidelines with various instruments. The People's Bank of China is expected to be the first to release a set of policy-sponsored criteria for green bonds.¹⁵⁷

The European Commission, together with the European Investment Bank, is creating a Natural Capital Financial Facility¹⁵⁸, as a green financial instrument with a total budget of €100 million and €10 million for technical assistance. The purpose is to fund, also through intermediaries, green infrastructure projects, investment to promote bio-diversity and adaptation to climate change. However, the mechanism has been criticised as leading to social and environmental losses rather than real solutions.¹⁵⁹

3.6.2 Private sector practice of social and environmental investment instruments

Examples: International Association of Investors in the Social Economy (INAISE), SFRE

Financial institutions have been creating and issuing investment funds and investment instruments that specifically invest in companies, projects or initiatives with social and environmental aspects, each with their own voluntary criteria. The *International Association of Investors in the Social Economy (INAISE)* has been forming a coalition that includes issuers of social and environmental investment funds to improve the latter's performance. Members of INAISE are finance organisations that invest in and issue investment instruments for 'undertakings of an ethical, ecological, cultural, collective and self-managing nature, across cultures and genders, including fair access to finance, sustainable support of the developing world, and in favour of the social economy generally'.¹⁶⁰

154 One of the many critical articles includes: McHugh, N., Sinclair, S., Roy, M., Huckfield, L., Donaldson, C., Social impact bonds: a wolf in sheep's clothing? *Journal of Poverty and Social Justice*, Vol. 21 no 3 , p. 247-57, <https://www.deepdyve.com/lp/policy-press/social-impact-bonds-a-wolf-in-sheep-s-clothing-Ly20LSP5sU> (4 December 2014).

155 Gustke, C., Art. 'A Scarce Global Resource Fighting Climate Change', CNBC, 1 July 2014, <http://www.cnbc.com/2014/07/01/world-is-running-short-on-green-bonds.html> (20 October 2015): US\$19.9 billion in green bonds had been issued by July 2014, compared to a total of US\$10.9 billion for all of 2013.

156 Grene, S., Art. 'Soaring Green Bond Growth Raises Need For Standards', *Financial Times*, 9 March 2015.

157 UNEP Inquiry, *The Financial System We Need*, p. 22.

158 See for an explanation: <http://ec.europa.eu/environment/biodiversity/business/assets/pdf/ncff.pdf> (20 October 2015).

159 Gilbertson, T., Coelho, R., *The natural capital financial facility*, November 2014, <http://www.carbonradewatch.org/downloads/publications/a-window-into-the-green-economy.pdf> (4 December 2014).

160 Information about members of Inaise: <http://www.inaise.org/?q=en/members-2015> (20 October 2015).

An example of a specific fund that invest in the social and responsible banking sector has been the creation in March 2015 by GABV of an open-ended investment umbrella fund ('Sustainability, Finance, Real Economies' (SFRE)¹⁶¹) to attract long term-capital for a broad range of banks that have a proven track record of serving the real economy and the needs of the communities in which they operate.

3.7 Civil society pressure as a strategy for voluntary change to social and environmental investments

Civil society organisations have been using diverse strategies to encourage a much more substantial amount of investment to flow towards social and environmental objectives. While advocacy and lobbying are directly addressing policy-makers and financial authorities, many campaigns exist to indirectly or directly target the investment industry and investors' decisions. Only a few strategies are being mentioned below as an illustration.

3.7.1 Influencing public opinion to pressure particular investing institutions for change

Examples: Facing Finance, ShareAction's Citizen investment movement and media campaigns, the Fair Insurance Guide, many fossil free campaigns, etc.

Many campaigns exist to influence public opinion and stimulate public debates in order to create pressure on investors and issuers of investment instruments (e.g. mutual investment funds, pension funds) to change their investments in projects and companies that for instance breach human rights and destroy the environment. In the run-up to the climate summit COP21 in Paris in December 2015, there are a huge amount of campaigns involving CSOs and citizens to make investors such as pension funds divest from assets that create CO₂ emissions.

Some of the more long-running actions include, for instance, Facing Finance, a coalition of NGOs and networks that campaigns towards institutional, public and private investors to not invest in any funding instrument of companies profiting from violations of human rights, environmental pollution, corruption or the production of controversial weapons.¹⁶² Another example is ShareAction's movement to engage citizens¹⁶³ to close the gap with their pension savings and redress the lack of voice they have in the investments funded by their money. It encourages pension savers to engage with and challenge their pension fund on issues such as the environmental and financial risks posed to investment portfolios through holdings in fossil fuel companies. A specific example is ShareAction's

161 For more information, see: <http://www.sfrefund.com/> (20 October 2015).

162 For more information, see: <http://www.facing-finance.org/en/die-kampagne/> (20 October 2015).

163 See: <http://www.shareaction.org/campaigns>.

Green Light campaign, which provides education on why pensions matter for climate change and has supported thousands of pension savers to engage with their pension providers on this matter.

Country centred campaigns include the fair insurance guide (*eerlijke verzekerings wijzer*) in The Netherlands, which identifies unethical and unsustainable investments by insurance companies, for instance, by exposing investments in weapon-producing companies that deliver to dictatorial or corrupt countries.¹⁶⁴

3.7.2 Shareholders' actions targeting investing institutions

Many NGOs have used the annual shareholder meetings of banks and investing institutions such as insurance companies to raise their concerns and make demands to stop and prevent financing and investment in projects and companies that are harmful for the environment and breach human rights. They have also pressed institutional investors such as pension funds and mutual funds to become active shareholders who file shareholder resolutions (engagement strategy) against company decisions that go against social and environmental criteria. They have contributed to more shareholder resolutions that have been filed by financial institutions based on sustainability criteria.¹⁶⁵

Just one example of a NGO that supports shareholder action by institutional investors is the Dutch Vereniging van Beleggers voor Duurzame Ontwikkeling (*VBDO*)¹⁶⁶, an umbrella organisation that operates for institutional and individual investors by asking questions about sustainability issues at shareholder meetings, based on research and network meetings. Interestingly, institutional investors in The Netherlands have created their own network called *Eumedion*¹⁶⁷ to support their activities to improve corporate governance and related sustainability performance.

164 See for instance: Eerlijke verzekeringswijzer, [website information], 18 June 2015, <http://eerlijkegeldwijzer.nl/verzekeringswijzer/nieuws/2015/verzekeraars-investeren-6-8-miljard-euro-in-foute-wapenhandel/> (20 October 2015).

165 See for instance: Lake, R., Financial Reform, Institutional Investors and Sustainable Development – A Review of current Policy Initiatives and Proposals for Further Progress, CalPERS/Unep Inquiry/Rob Lake Advisors, September 2015; different publications and web information by Ceres: <http://www.ceres.org/press> or <http://www.ceres.org/resources> (20 October 2015).

166 <http://www.vbdo.nl/> (20 October 2015).

167 <http://eumedion.nl/en/abouteumedion#what-does-eumedion-do> (20 October 2015).

3.8 Multi-stakeholder platforms, knowledge networking, think thanks, etc. as a non-governmental approach to change thinking and practice

Examples: Network for Sustainable Financial Markets, ASrIA, The Rotman International Centre for Pension Management, Sustainable Finance Lab, 2° Investing Initiative, Center for Banking, Finance and Sustainable Development

Behind many of the above mentioned initiatives, activities, and practices are different kind of organisations, networks and think thanks that involve investing financial institutions or that target them. This knowledge building can be organised by the financial industry itself, by non-governmental organisations, through multi-stakeholder platforms, or led by think thanks or university research, etc. Only a few examples are being listed above.

Concluding remarks

This report indicates that initiatives to integrate social and environmental sustainability aspects in the banking and investment segments of the financial sector have grown substantially in recent years. A diverse range of voluntary instruments and initiatives are operational, concrete practicing of sustainable banking and investment has increased and even an entire industry sells its services to those in the investment industry who want to invest in a more sustainable way. More recently, a few regulations with binding requirements have been introduced in some (non-Western) countries. The apparent imbalance between the initiatives to meet social and equity objectives and the many more initiatives to meet environmental objectives might be due to the present-day focus on climate change and the Paris climate summit at the end of 2015, and due to activities and initiatives by UNEP Inquiry project that focused on 'green' sustainability.

By mapping the sustainability initiatives in finance according to their 'strategies' or approaches, this report makes more apparent that binding regulatory tools and policy options have been less used than various voluntary or industry-driven initiatives. However, binding regulation rather than voluntary commitments can be a more effecting way of substantive change in the financial industry, as the UNEP Inquiry's final report also points out.¹⁶⁸ Such approach has been increasingly taken by developing and emerging economy countries while developed countries are lagging behind. Only in 2015 have multilateral fora that are decisive for financial regulation (G20, FSB) given attention to the impact of climate change on the investment sector, while since long many UN or other voluntary global initiatives on different aspects of social and environmental banking and investment have been developing.

No easily available overview of all the initiatives exists -even this report could not be complete-, nor is there sufficient information about the actual impact and concrete practice¹⁶⁹ of the various initiatives and approaches revealed in this report. Of the many discussion points and questions that this report might raise, one question in particular stands out: what is the real-world effectiveness of the various approaches cited in this report? In order to facilitate the discussion and assessment of the different strategies and their effectiveness, the following questions could be useful:

Regarding regulation, will it really manage to channel capital into less harmful kinds of real assets and channel money to the poor? Are mandatory regulations strict enough and do they ban financial sector practices that are considered particularly harmful to people or the environment? Are there unintended consequences and how harmful are they to whom? Is the challenge of effective enforcement being met given that financial actors are very resourceful and innovative when it comes to circumventing regulation?

168 UNEP Inquiry, *The Financial System We Need*, p. xv.

169 BankTrack, *Four steps for the Equator Principles to regain their ambition and relevance*, press release, 19 October 2015: even long-term campaigning by BankTrack to find out how the Equator principles are used has not revealed the necessary information.

What impact do the various voluntary initiatives and market-driven or industry-driven approaches and practices have? Since financial actors are known to be dealing with external demands and critique through window-dressing and box-ticking approaches to compliance, how will imposing sustainability-related disclosure requirements lead to actual changes in the behaviour of financial intermediaries and the companies they finance? How do the existing voluntary measures attempt to make attention to sustainability aspects internal to all the operations of a financial company (bank, insurance company, institutional investor, etc.)? How far will voluntary measures go beyond dealing with material impacts, i.e. clearly visible impacts while neglecting ethical aspects of future effects?

What will effectively change if the old paradigms of the financial system continue and systemic issues are not addressed? Will sustainable investment remain a niche market for investors while high profitability, economic efficiency, short-termism and excessive leverage remain important drivers that side-line long-term and sustainable decisions? Would it be better to tackle the over-sized, over-complex financial actors, and tackle financial sector expansion and credit over-expansion that fuels inequality¹⁷⁰ and thus undermines social sustainability objectives?

Who will be the driving forces for effective change? If 'every big advance in social justice began as a civil society movement',¹⁷¹ would it be up to civil society that currently faces huge lack of resources to work on the financial system and is easily side-lined by a powerful financial sector lobby? Will the central bankers drive the change as seen in Brazil, China and Indonesia, or will they be curtailed by their mandates or opposition of the financial industry? Given the long-term resistance by the huge majority in the financial industry against any long-term economic and financial reform, can change come when its power is not being curbed?

Faced with such complex questions, an agenda for effective progressive and sustainable financial sector reform will have to be coherent and complementary. It might involve a choice, or a compromise, whether the principal goal of a financial reform agenda is:

- to create a do-no-harm financial system that is less prone to crisis, less prone to affect the wider economy and do less harm from a social and environmental sustainability perspective?
- to reduce the financial system to a subservient role where it primarily finances non-financial entrepreneurship and societal needs in a social and environmental sustainable way?; or
- to create a whole financial system that plays an active and positive role in moving the economic system and societies towards social fairness, ecological sustainability and more democratic control?

170 OECD, How to restore a healthy financial sector that supports long-lasting inclusive growth, 2015, <http://www.oecd.org/eco/How-to-restore-a-healthy-financial-sector-that-supports-long-lasting-inclusive-growth.pdf> (20 October 2015).

171 FinanceWatch, Annual Report, 2013, p. 5.

Mobilising the financial sector for a sustainable future

Mapping existing approaches to promote social and environmental sustainability goals in the financial sector

This report provides an insight into the search for a financial system that is not only financially stable but one that serves the needs of societies and economies that develop in an equitable, inclusive and environmentally sustainable way.

The goal of this report is to be a source of information for civil society and others with an interest in addressing sustainability in the financial sector in the most effective way. This report not only attempts to map what initiatives exist but also tries to identify the different approaches that are used on how to integrate social and environmental sustainability aspects in the banking and investment sectors. Each chapter in this report is therefore divided up according to the approaches or 'strategies', such as:

- mandatory regulations
- policy and incentives
- voluntary measures
- financial industry alternatives
- citizens' advocacy and campaigns

Given the many initiatives this report could not be complete nor provide an in-depth analysis, given the little information available about the actual impact of the initiatives. The report includes however a few critical comments on the practice and assumptions that underpin some initiatives, and offers an outline for further analysis, assessment and discussion about the many existing initiatives in the concluding remarks.

