6 Creating sustainable opportunities

A lot of work to be done

There has been an increasing focus on sustainable finance and on the implications of climate change for financial stability since 2015. From a financial regulatory perspective, two leading projects are: the FSB's Task Force on Climate-related Financial Disclosures (TCFD) recommendations - global level - and the creation of a European Expert Group on Sustainable Finance (EEGSF) in the EU. Nevertheless, sustainable finance is at a very nascent stage and there is still a lot of work to be done.

A step in the right direction

The TFCD's Recommendations aim at being adoptable by all organisations (not just the financial industry). They are expected to foster institutions' governance, strategy and risk management while at the same time bolstering the opportunities derived from the transition to a lower-carbon economy. Their three main goals are to[4] **i)** promote alignment across existing disclosure regimes; **ii)** consider the perspectives of users and the concerns of preparers of climate-related financial disclosures; **iii)** be efficiently implemented by organisations in their financial reporting.To achieve these goals, internationally accepted definitions of the key concepts, such as the definition of carbon-related assets are a must.

From the financial industry's perspective, the TFCD's Recommendations will be helpful for reducing investors' uncertainty, as they will be able to make better-informed decisions. Furthermore, the Recommendations will shed some light on policymakers' understanding of the risks and the market context. In that vein, physical, transition and liability risks have to be considered. Physical risks refers to the impact that climate and weather-related events, such as natural disasters, can have on insurance liabilities and on financial assets. Transition risks could materialise if transition to a low-carbon economy occurs late and abruptly, implying significant changes in the policies and the prices of fossil fuels and related assets. Liability risks could emerge if parties who have suffered the consequences of climate change seek compensation from those they consider responsible[5].

A global sustainable finance strategy should be a common goal and the EU has the potential to play a leading role in this field. The creation of an EEGSF, which started its work last January, is a milestone towards this objective. It was established by the European Commission in its priorities for 2017 for completing the Capital Markets Union.

The EEGSF's main task is to develop a comprehensive European strategy on sustainable finance, by supporting investment in green[6] technologies and ensuring that the financial system can finance growth in a way that is sustainable. In order to achieve this the Group will provide policy recommendations for mobilising public and private capital towards sustainable projects while minimising the materialisation of possible risks in the financial system derived from the exposure to carbon intensive assets.

4: Sources: The FSB-TCFD's Recommendations Report, the Technical Supplement on the Use of Scenario Analysis, and the Annex-Letter: Assessment & Summary.
5: Insurance and reinsurance sectors will be affected as a consequence of their role as insurers of third-party liability claims.
6: Currently, there is no an *official* definition for *green*. The *green certificate* is obtained through an environmental consultant and it is granted to the support of specific environmental initiatives.

Other sustainable initiatives and projects to be aware of

Financial instruments and projects have to abide by some requirements to be considered sustainable. Broadly speaking, a green authentication has to be provided by an independent environmental consultant. Furthermore, it has to comply with the Environmental, Social And Governance (ESG) Criteria, with the goal of the project being specifically environmental (e.g. for renewable energies). Last but not least, there are specific principles depending on the type of products (e.g. the Green Bond Principles for bonds).

At global level, the International Finance Corporation (IFC), a World Bank Group member, has recently launched a programme offering a broader range of investment opportunities in triple-A rated assets that meet ESG standards. It combines its already existing *Inclusive Business* and *Banking on Women bond programmes*. The IFC expects to increase the issuance volume of its responsible social bonds -through benchmarks bonds, private placements and retail market bonds. This new Programme on Social Bonds is aligned with ICMA's Social Bond Guidance and includes the four core components of the Green Bond Principles[7].

In Europe, green financial instruments are also gaining traction. Poland and France have already issued their respective Green Sovereign Bonds. The European Covered Bond Council is working on an initiative on Energy Efficient Mortgages that has the explicit support of the European Commission. Finally the Centre for Climate Change Economics and Policy has recently released its agenda for stimulating private market development in green securitisation.

Concluding remarks

A credible and and internationally accepted framework that provides financial stability to the financial projects is of the utmost importance. In that vein, two necessary conditions need to be highlighted: **i)** overlappings and inconsistencies with existing requirements have to be avoided because they can be misleading to investors and stakeholders; **ii)** Fluid and clear communication, cooperation and coordination among all the players - organisations, international bodies and standard setters - is of the utmost importance.

The main challenge is making the best economic and financial decisions today, bearing in mind relevant future implications in the coming years of those choices, and at the same time avoiding severe financial shocks and losses in asset values. **Last but not least, the current digital transformation** can be used as the lever for the enhancement of valuable information and its disclosure.

7: Use of proceeds, process for project evaluation and selection, management of proceeds, and reporting.

DISCLAIMER

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