The Evolution of Sustainable Finance
As attitudes among the public and policymakers have shifted, the finance sector has responded. Sustainable finance is now a hot topic for investors, banks and corporates around the world.

TWO decades ago when The Asset launched, sustainability was far from the top of the agenda for many in the finance world. Certainly, there were socially-responsible investors, some of which had emerged from philanthropic trusts or religious societies, and others that were established from the 1960s onwards as the mutual fund industry in the US rapidly expanded. But they were a tiny component of the investment community – and in Asia barely existed.

The situation was similar for corporates. The growth of capital markets helped to improve governance at many companies in the 1980s and 1990s, but environmental and social issues were not the focus. In Asia – and most notably China, which 20 years ago was in the midst of one of the greatest periods of economic growth in human history – this was especially the case: development and wealth creation were the near exclusive goals of business.

Fast forward to 2019 and everything has changed. The experience of the financial crisis has reshaped the economic and political environment. Most importantly, awareness of – and attitudes towards – the world’s environmental, social and governance (ESG) challenges have been transformed. To take one recent example, the public in many countries has called for action on plastic pollution in our oceans; governments around the world have responded by banning or taxing single-use plastics.

As attitudes among the public and policymakers have shifted, the finance sector has responded. Sustainable finance is now a hot topic for investors, banks and corporates around the world. It is becoming increasingly sophisticated, with new frameworks, initiatives and financial products emerging, and a growing distinction between the use of risk filters (to do no harm) and impact.
I would like to congratulate The Asset on its 20th anniversary. The publication has long been a dependable source of intelligence to the industry and it will no doubt continue to provide valuable insights as Asia embarks on the next, increasingly sustainable, phase of its development.

Landmarks in sustainable finance
The development of sustainable finance has been incremental but a handful of events highlight how sustainability has edged towards the mainstream.

• The UN Millennium Development Goals (MDGs) in 2000 were agreed to by all the world’s countries and leading development institutions. They raised awareness and provided a framework for the finance sector to understand its impact on sustainability (which, importantly, was defined as including economic, social and environmental objectives).
• The MDGs directly informed the 2015 UN Sustainable Development Goals (SDGs), which took a more expansive and ambitious approach to development, social and environmental issues. Finding innovative ways to fund the annual US$2.5 trillion SDG investment gap in emerging and low-income countries is now a core focus for sustainable finance.
• The MDGs were also important in setting the scene for other initiatives. These include the Global Reporting Initiative (GRI), which helps organizations understand and communicate their impact on issues such as climate change, human rights and corruption: 93% of the world’s largest 250 corporations now report on their sustainability performance using GRI standards.
• The investment management world is perhaps still waiting for its breakthrough moment in terms of standards but has made some advances. The creation of the Dow Jones Sustainability Index in 1999, the Asia Pacific Index in 2009 and other indices have made it easier for investors to select companies with a best-in-class approach to economic, environmental, and social issues. ESG investing is now close to a tipping point in terms of public demand for ESG investment products and the adoption of ESG screens by mainstream investors.
• The UN Principles for Responsible Investment (PRI), which launched in 2006, have helped investors to meet their commitments to beneficiaries while aligning investment activities with broader ESG goals. Global assets managed by the UN PRI’s 1,961 signatories (often used as a proxy for ESG investment) have grown by double-digit percentages in recent years and reached US$81.7 billion in April 2018.
• The development of green and social bonds has created a valuable new financing tool for corporates (and sovereigns). The first green bond was issued by the European Investment Bank in 2007 to finance its climate-related projects. In 2018, a record US$247 billion worth of green, social or economic sustainability-themed debt instruments were issued. In recent years, China has become a major issuer of sustainable debt and last year sold US$25.5 billion in bonds. The International Capital Markets Association’s green bond principles in 2013 and other organizations such as the Climate Bonds Initiative have helped to strengthen the market.

Why sustainable finance is gaining ground
Both investment managers and corporates increasingly accept that consideration of ESG factors does not hamper investment returns. In fact, it can deliver risk and performance benefits. A report by Boston Consulting Group shows that non-financial performance (captured by ESG metrics) is statistically significant in predicting the valuation multiples of companies in a variety of industries.

Other evidence confirms the significant financial benefits of ESG factors. The IFC analysis of 656 companies in its portfolio found that those with a good environmental...
and social performance outperformed others by 210bp in terms of return on equity and by 110bp on return on assets. As the IFC notes, “companies that do good by the environment, their labour force, and communities, do well financially”.

Companies that focus on ESG issues are more highly valued and can perform better because they have a lower cost of capital due to their superior risk profile (they are more profitable and will outperform should unexpected events occur), according to an MSCI report. In short, even if one were to ignore any ethical imperatives for companies to commit to ESG and investors to consider ESG factors, there appear to be clear financial rewards from adopting ESG as best practice.

The role of banks
Public opinion will continue to drive the growth of sustainability. New regulations will also entrench sustainability for business and finance. The European Union plans to develop a climate mitigation classification system, a green bond standard, benchmarks for low-carbon investment, and guidance on corporate disclosure of climate-related information. And in China, all listed companies and bond issuers in the country will have to disclose ESG risks by 2020.

As key intermediaries in the financial system, banks have a central role to play in furthering sustainable finance. By committing to deliver long-term value for their shareholders, society and the environment, banks can make a real difference while benefiting from an enormous opportunity: the IFC estimates there are US$23 trillion of climate-related sustainable finance opportunities in emerging markets alone in the years to 2030.

Banks have a powerful tool – financing – to promote change. They can blacklist industries that contribute to climate change such as coal-fired power, agro-industries involved in deforestation, or sectors where there are human rights violations, for example. And they can support microfinance, renewable power, blended finance (which uses development finance to leverage private sector funds) and other financing that promotes sustainability.

Banks may need to invest the resources to deliver the enhanced data transparency that sustainability requires. Risk and frontline staff might need training to understand sustainability so they can help clients to navigate this rapidly changing world and take advantage of new opportunities, such as the sustainability-themed bond market or growing demand for ESG-focused investment products. However, by working with communities to deliver programmes that promote social and economic development, banks can ensure that sustainable finance delivers benefits for all in the long term.

Simon Cooper is CEO of Standard Chartered’s Corporate, Commercial & Institutional Banking division.

For citations, please see page 113.