SUSTAINABILITY IN FINANCE SECTOR

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1. Overview

Traditionally, the activities in the finance sector have predominately revolved around the financial bottom-line. This means that financial considerations, most notability profit/revenue maximization with cost minimization, have been the dominant factors assessed for investments, loans, stock exchange, and so on.

However, the emerging trend of sustainability solidified the importance of non-financial considerations throughout business practices across all sectors—and the finance sector is no different. Furthermore, sustainability now is rising on the agenda of the financial services sector. Clients ask for it, legislation requires it, and society calls upon the financial services sector to contribute to a sustainable future.

Banks, insurance companies, private equity and other market players are crucial to realizing the transformation to a sustainable economy.

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2. How sustainability drives finance sector

Sustainability elements play various important roles in driving the activities of financial institutions. This includes, for example, embedding sustainability elements into:

- Employees and workplace environment
- Environmentally-friendly activities
- Green and local procurement practices
- Giving back to society
- Engagement with stakeholders

More specific to finance, it is not enough to consider solely financial elements in carrying out financial activities, but other factors must be considered while investing or providing financial services—namely strategies that advocate for sustainability or environmental, social, and governance (ESG) elements. Nowadays, there is also increased legislative pressure on the implementation of the ESG factors into investment strategies and processes.

3. How finance sector drives sustainability

Just like sustainability drives the activities in the finance sector, financial institutions also have a role in driving the sustainability directions of their environment—ranging from the local communities in which they operate, to national and international levels.

More specifically, this prominent role in sustainability directions comes from financing and investment decisions made by investors to either accept, reject, or assign different terms to potential opportunities in accordance with the involvement of sustainability elements. For example, in efforts towards contributing to Goal #7 (Affordable and Clean Energy) of the UN Sustainable Development Goals (UNSDGs), financial institutions may adopt ESG investment strategies (i.e. environmental policy) that favor directly financing projects that enhance renewable energy in the nation—e.g. solar, wind, hydro, geothermal, etc.—and directly avoiding financing projects related to fossil fuels—e.g. oil, gas, coal, etc.

A more indirect contribution to Goal #7 would be to make financing decisions for a project based on the expected energy type, consumption, and emissions generation that would be used throughout said project, and similarly accepting and rejecting in line with Goal #7.

Besides simple rejection or acceptance of projects based on ESG, financing decisions may also provide different financing terms (i.e. interest, maturity) based on the ESG factors that are targeted for promotion.

Other than only Goal #7, financing activities can similarly be crafted by these ESG investment strategies to target other UNSDG goals—eventually contributing materially to the sustainability directions of nation.

4. Four key sustainability trends in finance sector

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1. Socially Responsible Investment (SRI):

As mentioned previously, ESG elements are increasing becoming important factors to consider throughout investors' strategies, besides the traditional financial considerations. This harmony has increasingly been named "Socially Responsible Investment," or SRI. Many factors led to this emerging trend, including fear of climate change, ethical standards, pressure from society to address human rights / socio-economic issues in business practices, and even financial motivations. Specifically, the financial considerations of ESG investment strategies are spurred from the growing evidence pointing to the positive correlations between SRI / ESG and financial returns to the organizations—and by extension, the investors.

2. Environment, Social, and Governance (ESG) Ratings:

In line with the trend of SRI comes the trend of ESG rating, where several rating agencies assess listed companies to provide a periodic ESG rating. These ratings are often based on vast technical criteria, which are calculated based on percentiles, risk assessments, etc. These ESG ratings have a strong impact as they are often used by investors to make their financing decisions, especially in line with the trend of integrating ESG elements in investment portfolios. Some of the ESG rating organizations include, but are not limited to:

A	B	C	D	E
Thomson Reuters	FTSE Russel	DowJones Sustainability Index (DJSI)	MSCI	Mercer

3. Principles of Responsible Investment (PRI):

PRI is a UN-supported international network of signatory investors that work towards implementing ESG elements into investment activities worldwide. As of 2017, there more than 1,750 PRI signatories from over 50 countries.

One of the achievements of the PRI is the 2015 publication of Fiduciary Duty in the 21st Century—along with the UN Environment Programme Financial Initiative (UNEP FI), UNEP Inquiry, and UN Global Compact (UNGC)—which emphasized the fiduciary duty of investors to integrate ESG in investment decisions, and concluded that there is still a gap in integrating ESG issues in investment decision-making processes.

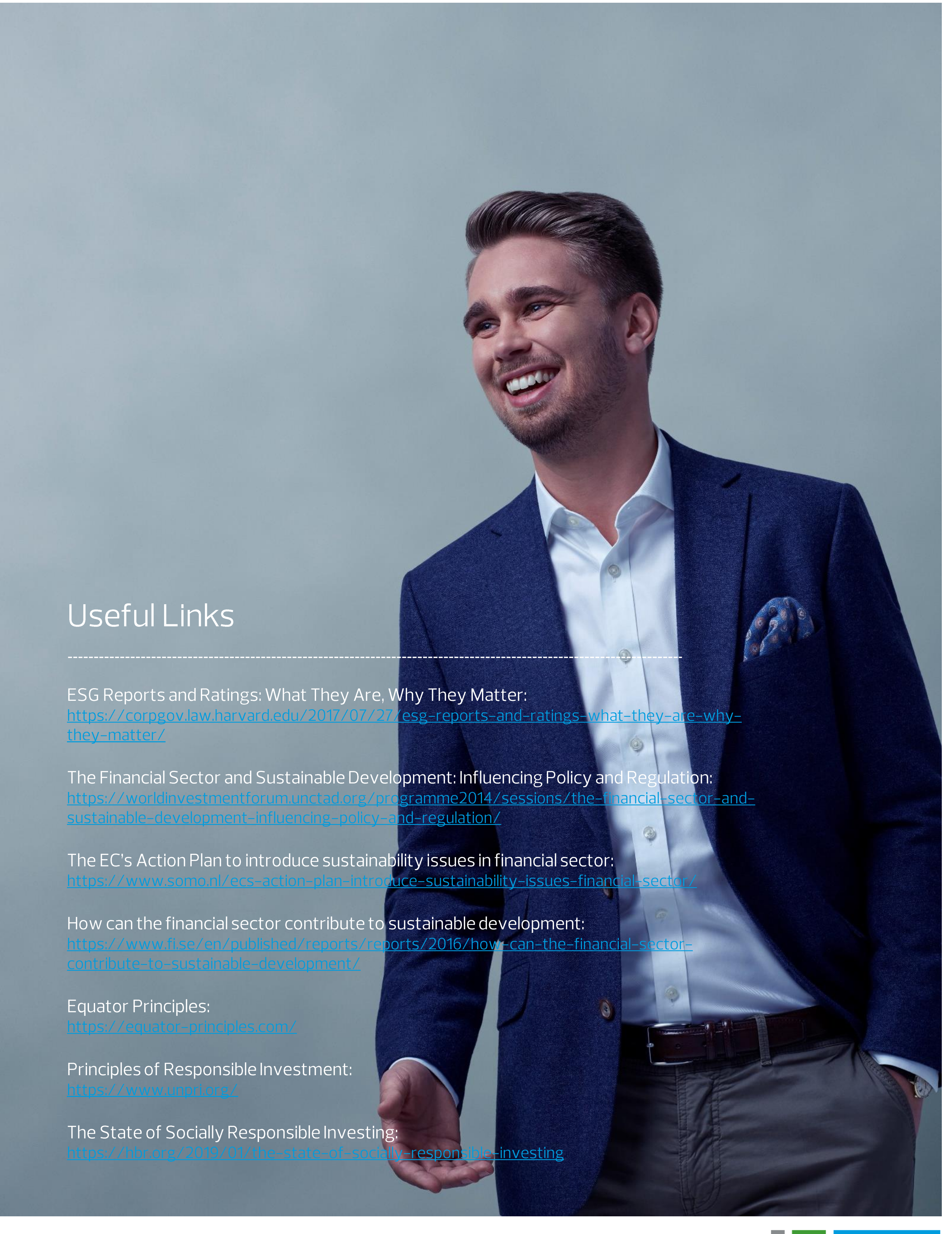
The six PRI principles are listed below:

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.

4. Equator Principles:

Traditionally, financial elements form the major considerations used by financial institutions to assess their potential financing clients and projects. Specifically, the risk related to potential projects have traditionally been financially derived. As an alternative, Equator Principles emerged as an innovative risk management framework that guides financial institutions in considering ESG risks, especially social and environmental risks, in their potential clients and projects. Accordingly, financing decisions and investment follow-ups and terms would stem from the results of the Equator Principles ESG risk assessments. The ten Equator Principles, which are mainly steps in the ESG risk assessment, are listed below:

#	Principle
Principle 1:	Review & Categorization
Principle 2:	Environmental and Social Assessment
Principle 3:	Applicable Environment and Social Standards
Principle 4:	Environmental and Social Management System and Equator Principles
Principle 5:	Stakeholder Engagement
Principle 6:	Grievance Mechanism
Principle 7:	Independent Review
Principle 8:	Covenants
Principle 9:	Independent Monitoring and Reporting
Principle 10:	Reporting and Transparency



Useful Links

ESG Reports and Ratings: What They Are, Why They Matter:
https://corpgov.law.harvard.edu/2017/07/27/esg-reports-and-ratings-what-they-are-why-they-matter/

The Financial Sector and Sustainable Development: Influencing Policy and Regulation:
https://worldinvestmentforum.unctad.org/programme2014/sessions/the-financial-sector-and-sustainable-development-influencing-policy-and-regulation/

The EC's Action Plan to introduce sustainability issues in financial sector:
https://www.somo.nl/ecs-action-plan-introduce-sustainability-issues-financial-sector/

How can the financial sector contribute to sustainable development:
https://www.fi.se/en/published/reports/reports/2016/how-can-the-financial-sector-contribute-to-sustainable-development/

Equator Principles:
https://equator-principles.com/

Principles of Responsible Investment:
https://www.unpri.org/

The State of Socially Responsible Investing:
https://hbr.org/2019/01/the-state-of-socially-responsible-investing

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