

## REPORT CARD: Finance

### Introduction

The financial services sector, which includes banking, insurance and asset management, has seen a vibrant period of sustainability-related activity since the August-September 2002 Johannesburg Summit. At the same time, the nature of sustainability challenges and opportunities for the sector has evolved into a more complex set of issues. Institutions are faced with operating in a globalising economy underpinned by environmental, social, economic and human rights issues with distinct regional and, in some cases national, specificities. This Report Card provides a brief update on developments since 2002 as well as mapping out how the sector will address sustainable development challenges in the future.

### Work in progress

**What we said in 2002:** incorporate sustainability principles into mainstream asset management; use voluntary standards and management systems to transfer knowledge to developing countries; development of universally accepted performance indicators and reporting standard through the GRI for banks, insurance companies...

Since 2002, two key challenges for the sector have included: the effective use of voluntary standards and management systems to transfer knowledge to networks and institutions in developing countries; and the development of universally accepted performance indicators and reporting standards for the global financial services industry.

*Reporting:* Between September 2003 and October 2004, a group of 10 financial service institutions and 10 NGOs negotiated a Global Reporting Initiative (GRI) standard covering environmental factors for the asset management, lending and insurance sectors. The pilot GRI standard was launched in October 2005 and now GRI and UNEP are working with leading financial institutions worldwide to test the new standard during the 2006–2007 sustainability reporting cycle.

*Asset Management:* Significant work has been undertaken by the asset management community in order to establish the materiality of social, environmental and corporate governance (ESG) issues. The key purpose of this ESG “materiality” work has been to facilitate more effective engagement on ESG issues by asset managers with corporations in which they invest. For example, in 2003 UNEP FI invited mainstream stockbrokers, including Goldman Sachs, Deutsche Markets and Nikko Asset Management, to analyse sustainability issues across seven industry sectors. This work has led to an informed dialogue on sustainability issues with the institutional investment community, including the world’s largest pension funds, foundations and special government funds. This has resulted in a partnership process, convened by the UN Secretary General in 2005, to develop a set of Principles for Responsible Investment (PRI) for institutional investors worldwide. The Principles were launched in April 2006.

*Insurance:* Global leaders in insurance and reinsurance have been notable for their engagement in the climate change debate, with companies such as Aviva, Axa, Insurance Australia Group, Munich Reinsurance and Swiss Reinsurance playing an influential role in bringing an insurance sector perspective to the policy arena at national, regional and global levels. Outside the climate change arena, the insurance sectors efforts to develop and market pro-sustainability insurance products and services has been more difficult and remains very much at the nascent stage.

*Lending:* Among the most notable developments since 2002 has been the emergence of the Equator Principles (EP), a voluntary standard covering environmental, social and human rights issues connected to project finance. From an initial four banks backing the Principles in late 2003, 41 banks representing more than 85 per cent of the global project finance market are now signatories. The EPs, and their effectiveness, are very much under the spotlight of civil society and non-government organisations. Many of the major OECD-based banks are addressing how they can embed sustainability into their core policies and practices across their main business lines. The process and institutional changes required are significant and require buy-in and support from the most senior executives within the institutions.

## Future challenges

**What we said in 2002:** growth in socially responsible investment screening; gaps between developed and developing world standards; facing new risks related to technology developments and issues such as climate change; growing importance of issues surrounding risk information, capital formation human resources and societal expectations...

*Asset Management:* In the asset management community there remains limited global capacity to manage the full range of ESG risks and opportunities regarding investments. Despite the established and growing body of evidence that environmental, social and governance (ESG) issues pose material financial risks to their investments, few asset managers offer portfolio-wide solutions to such risks. Extrinsic problems arise for asset managers due to the lack of sell-side research addressing ESG issues. Until asset managers send strong financial signals to the sell-side research community, including through specific mandates, it is unlikely that ESG issues will get much attention.

*Insurance:* By far the greatest challenge facing the world's insurance and reinsurance industry is climate change and its associated physical impacts. Insurance relies on detailed assessment of weather and its costs in order to price risks and provide a viable risk-transfer mechanism. Many observers feel that the industry should engage more directly with government policy-makers to further highlight the mid- to long-term economic risks posed by climate change, and should be a key player in communicating the likely scale of future costs of climate change to government and business. Separately, the insurance sector faces the ongoing challenges of communicating emerging risks associated with new technologies—such as GMOs and nano-technology—while forging the risk management approaches that ensure positive momentum around technological innovation.

*Lending:* For banks, several priorities are evident in the coming decade. First, banks need to identify the information that is required to deal with non-financial but economically relevant sustainable development-based risks. Second, economic values based on the near future sustainability priorities need to be integrated actively into credit project and debt finance business considerations. Third, a deeper understanding is needed of who are the lending sector's new stakeholders and how they will influence the emerging sustainability agenda. Certainly many of the global banks have made impressive strides in integrating ESG concerns, both in their own operations and in

terms of the other investment chain actors they influence. Often, however, the message does not radiate outwards from headquarters to “the field.”

## Partnership opportunities

As noted above in relation to the GRI, the sector has been active in encouraging practical partnerships. Opportunities for new partnerships are emerging. For example, the Principles for Responsible Investment (PRI) process is an effort, convened by the UN Secretary General, to identify and act on the common ground between the goals of institutional investors and the sustainable development objectives of the United Nations. The audience is global, with a goal of protecting the long-term interests of fund beneficiaries. Some 20 institutional investors representing US\$1.6 trillion in assets met between April and October 2005 to negotiate a set of Principles. This public-private partnership represents an important step towards fulfillment of the Principles of the UN Global Compact, the Millennium Development Goals and the objectives of the World Summit on Sustainable Development.

Another emerging partnership opportunity, notably for asset managers, is the Carbon Disclosure Project. CDP, now in its third year, has gathered asset owners and managers representing more than US\$21 trillion to press the importance of the way in which the world's 500 largest companies manage their carbon risks.

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